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OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINION BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-47a, 48a-49a) is not yet reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 50a) was entered on March 30, 1979. A petition for rehearing was denied on July 16, 1979

(App. C, *infra*, 51a-52a). On October 11, 1979, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including December 13, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 4(c)(8) of the Bank Holding Company Act, the Federal Reserve Board may authorize bank holding companies to organize and manage closed-end investment companies to the extent permitted by the Glass-Steagall Act.

STATUTES AND REGULATIONS INVOLVED

Pertinent statutory and regulatory provisions are set forth in Appendices F and G, *infra*, 80a-87a, 88a-91a.

STATEMENT

1. The Statutory Framework

Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), authorizes bank holding companies to acquire "shares of any company the activities of which the [Federal Reserve] Board * * * has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto."[1] The

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[1] A "bank holding company" is defined in Section 2(a)(1) of the Act, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [*inter alia*] * * *

Banking Act of 1933, ch. 89, 48 Stat. 162, contains several provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks, such as bank holding companies and their nonbank subsidiaries, in specified securities activities. The Glass-Steagall Act prescribes different rules for banks and bank holding companies.

Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, prohibits affiliates of member banks [2] from engaging "principally" in the issuance, sale, or distribution of securities. Section 20 expressly applies to holding companies of member banks. 12 U.S.C. 221a(b).

The limitations imposed by the Glass-Steagall Act on the securities activities of banks are stricter than those imposed on affiliates such as bank holding companies. Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides that national banks may not underwrite any issue of securities or stock. Section 16 also provides that national banks may buy and sell certain categories of securities only for the accounts of customers and not for their own account.[3] In addition, Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids organizations engaged in the business of issuing, underwriting, selling, or distributing

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the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *."

[2] Every national bank is required to be a member of the Federal Reserve System. 12 U.S.C. 282. A state-chartered bank may become a member bank upon application to, and approval by, the Board. 12 U.S.C. 321.

[3] State member banks are subject to the same restrictions that are applicable to national banks. 12 U.S.C. 335.

securities to engage in the business of receiving deposits—the business of banking.

2. The Board's Regulation and Interpretive Reading

On January 20, 1972, the Federal Reserve Board promulgated a regulation which provides that serving as an investment adviser to a registered investment company [4] is an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act and is therefore permissible for bank holding companies.[5] 12 C.F.R. 225.4(a)(5)(ii) (App. F, *infra*, 81a).[6] An accom-

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[4] The definition of "investment company" contained in the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, includes companies engaged primarily in the business of investing in securities. See 15 U.S.C. 80a-3(a). Certain investment companies are required to register with the Securities and Exchange Commission. 15 U.S.C. 80a-7, 80a-8.

[5] The Board's determination that an activity is "closely related to banking" does not, in itself, authorize any particular bank holding company to engage in that activity. A bank holding company must apply to the Board for permission to undertake such activity; the Board is then required to determine whether the public benefits resulting from the performance of the activity by the particular holding company outweigh any possible adverse effects. 12 U.S.C. 1843(c)(8). The Board also has authority to supervise holding companies so engaged to prevent the violation of federal law or regulation and to assure sound banking practices. 12 U.S.C. 1818(b)(1), (3); 92 Stat. 3646.

[6] The Board's regulation authorizing bank holding companies to serve as investment advisers increased the types of fiduciary services that holding companies might provide. The Board has also authorized fiduciary-type services such as advising real estate investment trusts, providing portfolio

panying interpretive ruling, 12 C.F.R. 225.125 (see App. F, *infra*, 83a-87a), sets forth the limitations that the Board concluded must be imposed on bank holding companies serving as investment advisers to comply with the Glass-Steagall Act, as construed by this Court in *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971). In light of *Camp*, the Board determined that certain activities ordinarily performed by investment advisers on behalf of investment companies are permissible, while others are prohibited.[7]

The Board's interpretive ruling draws a distinction between open-end and closed-end investment companies. The ruling prohibits a bank holding company serving as an investment adviser from organizing or controlling an open-end investment company, which typically stands ready to sell and redeem its shares at any time and thus is continuously engaged in the process of issuing securities. 12 C.F.R. 225.125(f), (c).[8] Closed-end investment companies, in contrast,

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investment advice, furnishing general economic information, and providing financial advice to state and local governments. 12 C.F.R. 225.4(a)(5)(i)-(v).

[7] In its interpretive ruling, the Board stated its view that the Glass-Steagall Act was not modified by the Bank Holding Company Act Amendments of 1970 and that, accordingly, the Glass-Steagall Act's restrictions on securities activities of bank affiliates must be applied to bank holding companies serving as investment advisers. 12 C.F.R. 225.125(b), (e), (f).

[8] Open-end investment companies are commonly known as "mutual fund[s]." *Investment Co. Institute* v. *Camp, supra*, 401 U.S. at 625 n.11. Under the Board's interpretive ruling, bank holding companies may only provide investment advice to, as distinguished from organizing or controlling, open-end investment companies. 12 C.F.R. 225.125(c), (f).

do not stand ready to redeem their shares and do not issue their shares after initial organization except at infrequent intervals. In light of this difference, the Board's interpretive ruling permits bank holding companies to organize or control closed-end investment companies, with the caveat that such management activities are permissible only if the investment company is not primarily or frequently engaged in the issuance of securities. 12 C.F.R. 225.125(f), (c). In addition, the Board's interpretive ruling expressly prohibits bank holding companies from engaging directly or indirectly in the sale or distribution of any securities issued by *any* investment company. 12 C.F.R. 225.125(h).

The interpretive ruling also imposes restrictions designed to eliminate potential conflicts of interest and unsound banking practices of the types discussed by this Court in *Investment Co. Institute* v. *Camp, supra*, 401 U.S. at 630-634, 636-639. Bank holding companies and their subsidiaries are forbidden to purchase for their own account securities of any investment companies that receive investment advice from such holding companies, and they are also forbidden to purchase such securities for any other person in a discretionary fiduciary capacity. Holding companies and their subsidiaries are also forbidden to extend credit to any such investment companies or to accept their securities as collateral except under limited circumstances. 12 C.F.R. 225.125(g). In order to insure their complete separation from in-

vestment banking, bank holding companies are likewise forbidden to distribute prospectuses or sales literature concerning their advisee investment companies, and such materials may not be made available at offices of the holding companies. Officers of bank subsidiaries may not express opinions concerning the shares of such investment companies, and the names of bank customers may not be furnished to investment companies or their representatives. The Board's interpretive ruling also strictly limits the making of cash deposits on behalf of an advisee investment company in any subsidiary bank of the adviser holding company. 12 C.F.R. 225.125(h), (i).

3. Respondent's Challenge to the Board's Regulation and Interpretive Ruling

In December 1973 respondent Investment Company Institute, a trade association of open-end investment companies, requested the Board to rescind its regulation and interpretive ruling. Respondent alleged that the regulation permitted activities that violate Sections 16 and 21 of the Glass-Steagall Act and therefore could not be authorized by the Board under the Bank Holding Company Act. In March 1974 and again in August 1977 the Board denied this request to rescind the regulation (Apps. D, E, *infra*, 53a-64a, 65a-79a).[9] The Board reaffirmed that, subject to the

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[9] Respondents filed a second petition for rescission of the Board's regulation after an initial attempt to obtain judicial review was denied on jurisdictional grounds. See *Investment Co. Institute* v. *Board of Governors of the Federal Reserve System*, 398 F. Supp. 725 (D.D.C. 1975), aff'd, 551 F.2d 1270 (D.C. Cir. 1977).

restrictions prescribed in its interpretive ruling, bank holding companies could serve as investment advisers to closed-end investment companies without infringing the Glass-Steagall Act. The Board also emphasized the close connection between traditional fiduciary services offered by banks and the provision of investment management services to closed-end investment companies: "banks historically have furnished investment advice to trust accounts; these include testamentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities" (App. D, *infra*, 62a).

The court of appeals, on review of the Board's order denying respondent's request for rescission, set aside the Board's regulation and interpretive ruling (App. A, *infra*, 3a, 47a). At the outset, the court of appeals rejected respondent's contention that organization or control of a closed-end investment company by a bank holding company violates the Glass-Steagall Act (*id.* at 14a-23a). Nonetheless, even though neither respondent nor any other party had directly raised the issue in any forum, the court concluded that the challenged regulation and interpretive rule exceeded the Board's authority under Section 4(c)(8) of the Bank Holding Company Act (App. A, *infra*, 23a-46a).

The court found "virtually no guidance" on this question in the legislative history of the Bank Holding Company Act as originally enacted in 1956 (App. A, *infra*, 30a). It concluded, however, that the Act's grant of authority in 1956 to bank holding companies to engage in "financial" and "fiduciary" activities closely related to the business of banking (70 Stat. 137) could not be construed to permit the management of closed-end investment companies because of the generally understood policy of the Glass-Steagall Act to divorce "investment from commercial banking" (App. A, *infra*, 30a). The court also concluded that the 1970 amendments to the Bank Holding Company Act (84 Stat. 1763) could not support the Board's regulation because Congress, at the time of enactment of the 1970 amendments, *believed* that the Glass-Steagall Act prohibited bank holding companies from operating closed-end investment companies. The court reached this conclusion even though it rejected respondent's contention that the Glass-Steagall Act *in fact* had such a preclusive effect (App. A, *infra*, 43a-44a).[10]

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[10] After handing down its opinion, the court issued an order amending the opinion by adding a sentence stating that the court was withholding judgment on the question whether bank holding companies and their nonbank subsidiaries may "render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies" (App. A, *infra*, 48a-49a).

REASONS FOR GRANTING THE PETITION

1. This case presents the important question whether Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), a provision authorizing bank holding companies to engage in activities "closely related to banking" as approved by the Federal Reserve Board, should be construed to forbid fiduciary-type activities of bank holding companies that are not prohibited by the Glass-Steagall Act. As a part of their ordinary banking business, banks have traditionally provided a wide range of fiduciary and financial advisory services that involve transactions in securities. The conclusion of the court of appeals that investment management services rendered to closed-end investment companies cannot be deemed "closely related to banking," despite their similarity to various fiduciary services provided by banks, is of great consequence not only to the bank holding companies that render such services but also to members of the public who invest in closed-end companies. The court's decision would require bank holding companies now engaged in such activities to terminate their involvement and would insulate other investment managers from future competition from bank holding companies.[11]

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[11] In addition, by holding that the organization and management of closed-end investment companies is not "closely related to banking," the decision calls into serious question the permissibility of such activities for banks, whose powers are by definition narrower than those of bank holding companies under 12 U.S.C. 1843(c)(8).

Banking organizations have traditionally been an important source of investment advice and management for investment companies.[12] At present, banking organizations manage ten closed-end investment companies, about one-sixth of all of the major closed-end investment companies. The total net assets of the closed-end investment companies so managed are valued at approximately $670 million.[13] In addition, the holding of the court of appeals prohibits any future entry by bank holding companies into this field.[14]

The control and organizational activities forbidden by the decision of the court of appeals are important functions of investment advisers. Investment companies are ordinarily organized and operated by their investment advisers.[15] As this Court explained in *Burks* v. *Lasker*, No. 77-1724 (May 14, 1979), slip op. 9, most investment companies are "formed" and

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[12] In 1976, the largest 115 banks and their nonbank affiliates provided some form of investment advice to 159 investment companies (16% of all registered investment companies) which held assets of over $6 billion. See SEC Final Report on Bank Securities Activities 146-148 (1977).

[13] See Wiesenberger, *Investment Companies Service*, "Management Results" (September 1979). Respondent's challenge to the Board's regulation has been pending almost continuously since 1973 and has undoubtedly deterred some bank holding companies from seeking to become investment advisers to closed-end investment companies.

[14] At year end 1978, there were 2,222 registered bank holding companies in operation. See Board of Governors of the Federal Reserve System Annual Report 358 (1978).

[15] See 12 C.F.R. 225.125(e).

"managed" by external investment advisers that "select the funds' investments and operate their businesses." See also *Tannenbaum* v. *Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). By prohibiting bank holding companies from organizing closed-end investment companies,[16] the decision of the court of appeals will curtail the creation of new closed-end companies.

Moreover, as we have noted above, to the extent that the court of appeals intended to prohibit discretionary investment management and its ordinary incidents, the decision below will effectively preclude bank holding companies (and perhaps banks as well) from serving as investment advisers to closed-end companies that have already been formed, since discretionary investment authority is an essential advisory function.[17] To be effective, the adviser must itself be able to purchase and sell investments on behalf of its advisee, as well as perform other administrative and custodial services in connection with the management of the company's portfolio. Bank holding company investment advisers will not be able to compete effectively if limited to providing a list of suggested investments to advisee investment companies. The limitations imposed by the decision of

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[16] The Board's regulations do not permit bank holding companies to organize open-end investment companies (mutual funds). See 12 C.F.R. 225.125(f).

[17] See *SEC Institutional Investor Study Report*, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 167, 266-270 (1971) (75% of registered investment companies delegate "sole investment authority" to their investment advisers).

the court of appeals therefore have substantial practical importance.[18]

2. The decision of the court of appeals rests on a misconstruction of the plain meaning of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). As this Court has frequently pointed out, the primary guide in a case of statutory construction is the language of the statute itself. *Touche Ross & Co.* v. *Redington*, No. 78-309 (June 18, 1979), slip op. 7; *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977). By its terms, Section 4(c)(8) provides that bank holding companies may engage in activities that the Board has determined to be "closely related to banking." The statute does not define the activities that are permissible, and it does not proscribe any activities. Rather, it delegates the process of delineation to the expert agency. The lower courts have consistently held that Section 4(c)(8) leaves to the discretion of the Board the task of defining precisely which activities are permissible.[19]

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[18] Bank holding companies also furnish investment advisory services similar to those at issue here (under regulatory provisions not directly challenged in this litigation) to investment funds other than investment companies. See note 6, *supra*. These investment vehicles, including real estate investment trusts, small business investment companies, and pooled employee benefit plans, are often structured similarly to closed-end investment companies. The reasoning of the court of appeals could be extended to prohibit these customary services of bank holding companies and their subsidiaries.

[19] *National Courier Ass'n* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975); *Alabama Ass'n of Insurance Agents* v. *Board of Gov-*

Section 4(c)(8) does not, on its face, exclude securities-related activities from the realm of activities that are closely related to banking. And since Congress has long authorized national banks to serve in various fiduciary capacities involving securities transactions (see 12 U.S.C. 92a), no such limitation can logically be implied.[20] Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, however, expressly prohibits bank affiliates, including bank holding companies, from engaging "principally" in the issuance or distribution of securities. As a result, the Board is empowered by Section 4(c)(8) to authorize fiduciary-type activities to the extent not prohibited by Section 20 of Glass-Steagall—that is, only to the extent that the bank holding company is not authorized to engage "principally" in the issuance or distribution of securities.

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ernors of the Federal Reserve System, 533 F.2d 224 (5th Cir. 1976), modified on other grounds, 558 F.2d 729 (5th Cir. 1977), cert. denied, 435 U.S. 904 (1978); see also *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, 568 F.2d 549 (7th Cir. 1978).

[20] Commercial banks today, operating through trust departments, are the nation's largest institutional investors. See *SEC Institutional Investor Study Report, supra*, at 413-494. At the end of 1978, trust departments of insured commercial banks held over $441.8 billion in assets. American Banker, Nov. 16, 1979, at 1, col. 1. Bank trust departments administer common trust funds, employee benefit trusts, institutional and corporate agency accounts, as well as personal trust and agency accounts. See *SEC Institutional Investor Study Report, supra*; see also 12 C.F.R. 9.18 (prescribing rules for collective investment funds operated by national bank trust departments).

The Board acted reasonably and in accordance with law in finding that the organization and management of closed-end investment companies, as circumscribed by the Board's regulation and interpretive ruling, are activities "closely related to banking" under Section 4(c)(8) and do not result in bank holding companies becoming "engaged principally" in the issuance or distribution of securities. A bank holding company serving as an adviser to a closed-end investment company is engaged principally in furnishing advice concerning the purchase or sale of securities and certain incidental services related to the day-to-day operation of the investment company.[21] Under the Board's regulation, such advisers are forbidden to engage directly or indirectly in the process of underwriting, distributing, or promoting the investment company's shares. 12 C.F.R. 225.125(h). The limited services that are permitted are functionally the same as those provided by banks through their own trust departments, which undoubtedly may organize, manage, and give advice to common trust funds that contain the aggregated assets of a number of individual trusts.

Because the Board's regulation authorizes a bank holding company to organize and manage only closed-end investment companies that issue securities infrequently, and because the holding company must be segregated from the underwriting process under the Board's regulation, the bank holding company is not

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[21] Such services may include providing the investment company with personnel, office space, and clerical and administrative assistance.

permitted to engage *principally*, if at all, in the issuance of securities.[22] The type of activity permitted under the Board's regulation is that of the fiduciary —a role common to commercial banks—not that of the investment banker.

The structure of the Bank Holding Company Act also confirms that Congress did not intend to prohibit bank holding companies from operating closed-end investment companies. Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly permits a bank holding company to acquire all (or part of) the shares of an investment company and to manage, control, and advise its subsidiary investment company.[23] In light of this provision,[24] it is difficult to contend that Congress believed investment company management

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[22] The Board has consistently distinguished between closed-end and open-end investment companies in applying the Glass-Steagall Act. See 12 C.F.R. 218.101 (1951 interpretation); 12 C.F.R. 218.102 (1960 interpretation).

[23] Under Section 4(a)(2)(A) of the Act, 12 U.S.C. 1843(a)(2)(A), a bank holding company is empowered to manage, control, and provide services to its subsidiaries, including an investment company subsidiary.

[24] While Congress was evidently considering the case of a wholly owned investment company when Section 4(c)(7) was enacted, see 102 Cong. Rec. 6853 (1956) (remarks of Sen. Robertson), the language of Section 4(c)(7) authorizes bank holding companies to acquire all or part of the stock of an investment company, and the legislative history indicates that the section was intended to apply to any investment company meeting the specified requirements. Thus, Section 4(c)(7) permits a holding company to manage an investment company in which other investors also have an interest.

to be a forbidden activity under the flexible standard of Section 4(c)(8).

3. Instead of construing the literal text of the statute, the court of appeals placed principal reliance on legislative history (App. A, *infra*, 24a-25a). However, the legislative history does not support the court's conclusion. The relevant history shows that Congress intended to leave to the Board the responsibility for designating those activities involving securities transactions that are permissible for bank holding companies subject to Glass-Steagall Act limitations. The legislative history also shows that Congress believed that investment advisory services for investment companies could be authorized by the Board subject to the restrictions of the Glass-Steagall Act.

As the court of appeals recognized (App. A, *infra*, 39a-40a), a prohibition in the House version of the 1970 amendments to the Bank Holding Company Act that would have precluded the Board from permitting holding companies to operate investment companies was stricken from the bill that was ultimately enacted.[25] The Committee Report on the Senate version of the 1970 amendments stated that the language of the bill would not preclude bank holding companies

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[25] See 115 Cong. Rec. 33133, 33139 (1969). The House supporters of this prohibition acknowledged that, absent such a prohibition, banking organizations might well have been authorized to operate even *open-end* investment companies (mutual funds). 115 Cong. Rec. 32897, 32902-32903, 33135-33136 (1969).

from operating either open-end or closed-end investment companies if such activities were consistent with the Glass-Steagall Act. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 15 (1970). And in agreeing on the language that was ultimately enacted, the Conference Committee expressly recognized that the Glass-Steagall Act would continue to serve as the touchstone in determining the range of permissible bank holding company securities activities. Section 4(c)(8) was intended neither to "enlarge" nor "contract" that range.[26]

In sum, the Board's regulation and interpretive ruling limit bank holding companies to those services that are fiduciary in nature, and accordingly the

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[26] The chairman of the Conference Committee stressed this point as follows (116 Cong. Rec. 42430 (1970) (emphasis supplied)):

> Mr. WILLIAMS of New Jersey. * * * I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.
>
> Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here.* We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. * * * In short, *we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act.*

standards of the Glass-Steagall Act are not infringed. The conclusion of the court of appeals (App. A, *infra*, 39a) that Section 4(c)(8) does not "cut back" on the Glass-Steagall Act is thus irrelevant to the question presented here. The Board's regulation gives full faith and credit both to the Bank Holding Company Act and to the Glass-Steagall Act by authorizing only those activities that are functionally analogous to the activities of bank trust departments and by segregating those activities from the process of issuing or underwriting securities.

4. Because the Board's regulation and interpretive ruling are supported by the plain meaning of the statute, as well as by its legislative history, and because Congress intended the Board to exercise its expert discretion in drawing the lines that it did, the court of appeals should have deferred to the Board's reasonable interpretation. See *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978) ("courts should defer to an agency's construction of its own statutory mandate"); *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973) ("the validity of a regulation * * * will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation' "); *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge and Frankfurter, JJ., concurring) ("Not only because Congress has committed the system's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases, I think their judgment

should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion"); see also *Investment Co. Institute* v. *Camp*, *supra*, 401 U.S. at 626-627.

The court of appeals erred in disregarding these principles of statutory construction and in striking down the Board's regulation and interpretive ruling.[27]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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DECEMBER 1979

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[27] Because the court of appeals has invalidated the Board's regulation and interpretive ruling on a nation-wide basis, there will be no opportunity to obtain the views of another circuit on the validity of these provisions.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1862

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

Petition for Review of an Order of the Board of Governors of the Federal Reserve System

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Argued October 18, 1978

Decided March 30, 1979

Before McGOWAN and WILKEY, *Circuit Judges*, and GASCH,* *United States District Judge* for the District of Columbia.

Opinion for the court filed by *Circuit Judge* McGOWAN.

McGOWAN, *Circuit Judge*: This direct review proceeding raises the question of whether federal bank-

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* Sitting by designation pursuant to 28 U.S.C. § 292(a).

ing legislation prohibits bank holding companies or their non-bank subsidiaries from acting as investment advisers to closed-end investment companies. Respondent Board of Governors of the Federal Reserve System (the Board) promulgated a regulation and accompanying interpretive ruling purporting to authorize such activity. Petitioner, a national association of mutual funds,[1] charged, both in the administrative proceedings and before this court, that the Board's action is (1) inconsistent with sections 16 and 21 of the Banking Act of 1933, 12 U.S.C. §§ 24 (Seventh), 378 (Glass-Steagall Act);[2] and (2) unauthorized by section 4(c)(8) of the Bank Holding Company Act of 1956.[3]

While we disagree with petitioner's argument as to the effect of the Glass-Steagall Act, our independent review of federal banking legislation convinces us that petitioner is entitled to relief under the Bank Holding Company Act. Because the statutory considerations that we have identified are somewhat different from those articulated by petitioner during the administrative proceedings, the Board was not

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[1] In a memorandum to the Board submitted September 23, 1971, petitioner described itself as "an association of 356 open-end investment companies, their 159 investment advisers, and 120 principal underwriters. These members, which include both "load" and "no load" funds, represent about 93 percent of the assets of all such companies in the United States." Joint Appendix (JA) at A-4 n.*.

[2] The Glass-Steagall Act is codified at various places in Title 12 of the United States Code.

[3] 12 U.S.C. §§ 1841 *et seq.*

pressed in those proceedings to develop at any length its views on these questions. However, although we normally pay considerable deference to the Board's interpretation of its organic statutes, *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 513 (1978), we think it unnecessary in the present case to remand to the Board for further evaluation of the considerations we have here identified. For we find that the statutory materials—which are as accessible to this court as they are to the Board—compel the result we reach herein; and we vacate the regulation and interpretive ruling under review.

I

Section 4(a) of the Bank Holding Company Act, 12 U.S.C. § 1843(a), generally prohibits bank holding companies, *i.e.*, companies that own or control one or more commercial banks,[4] from engaging in nonbanking activities either directly or through a subsidiary company. However, section 4(c)(8) of the Act, 12 U.S.C. § 1843(c)(8), exempts from this prohibition subsidiaries whose activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto."[5] Bank holding

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[4] *See* § 2(a) of the Act, *as amended*, 12 U.S.C. § 1841(a).

[5] Section 4(c)(8), *as amended*, provides that § 4's prohibitions shall not apply to

> shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a

companies are permitted to engage directly in activities authorized for subsidiaries by section 4(c)(8) by virtue of section 4(a)(2)(B) of the Act, 12 U.S.C. § 1843(a)(2)(B). The Board, acting pursuant to authority delegated in section 4(c)(8), has heretofore identified a number of activities as "closely related to banking," and therefore permitted to bank holding companies and their non-bank subsidiaries, in its Regulation Y, 12 C.F.R. § 225.4.

On August 12, 1971, the Board issued notice of a proposed amendment to Regulation Y [6] authorizing bank holding companies and their non-bank subsidiaries to serve as investment advisers to any investment company registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.* An investment company is a corporation or trust whose business is the investment and reinvestment of the pool of funds contributed by its shareholders. *See*

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proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. . . .

[6] 36 Fed. Reg. 16,695 (1971), corrected, 36 Fed. Reg. 17,514 (1971).

section 3(a) of the Investment Company Act, 15 U.S.C. § 80a-3(a). An investment adviser is a company that, in addition to rendering investment advice, typically organizes, manages and controls an affiliated investment company.[7]

The Board received numerous written comments on its proposal and, at the request of petitioner herein, held a public hearing in which petitioner and other parties presented further views. On January 28, 1972, the Board adopted the proposed regulation with certain minor clarifications. 12 C.F.R. § 225.4 (a)(5)(ii), 37 Fed. Reg. 1463 (1972). As amended, the regulation provides in pertinent part:

> (a) *Activities closely related to banking or managing or controlling banks.* . . . The following activities have been determined by the Board

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[7] One authority has characterized the investment company industry as follows:

> Although a few mutual funds are managed along conventional corporate lines by their own officers and directors, most of them are formed, promoted, and managed by external organizations that are separately owned and operated. These separate organizations are usually designated as "investment advisers." The advisers select the funds' investments and operate or supervise most other aspects of their business. In return for their services they receive an advisory fee. The fee is almost always a percentage of the value of the fund's net assets fluctuating upward or downward as the value of the portfolio changes.

Securities and Exchange Comm'n, *Public Policy Implications of Investment Company Growth*, H.R. REP. No. 2337, 89th Cong., 2d Sess. 8-9 (1966) (footnote deleted). *Accord*, S. REP. No. 184, 91st Cong., 1st Sess. 5 (1969).

> to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:
>
> . . . .
>
> (5) . . . (ii) serving as investment adviser, as defined in section 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act . . . .

The Board apparently intended, when it proposed this regulation, that it would apply equally to the two main varieties of investment companies, closed-end and open-end.[8] An open-end company (also commonly called a "mutual fund") is continuously engaged in issuing its shares and stands ready at any time to redeem them; a closed-end company typically does not issue shares after its initial offering except at infrequent intervals, and does not stand ready to redeem them. 12 C.F.R. § 225.125(c), 37 Fed. Reg. 1464 (1972).[9] During the course of the administrative proceedings, however, several participants, in-

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[8] Both of these are considered "management companies" under section 4 of the Investment Company Act, 15 U.S.C. § 80a-4. That section recognizes two other types of investment companies, "face amount certificate companies" and "unit investment trusts". *Id.* These are infrequently encountered and are not relevant to the instant case.

[9] *Compare* § 5(a)(1) of the Investment Company Act, 15 U.S.C. § 80a-5(a)(1) *with* § 5(a)(2) of the Act, 15 U.S.C. § 80a-5(a)(2). Shares in an open-end company are continuously bought from and sold to the company itself, while shares in a closed-end company, after the initial issuance, are typically bought and sold on the open market.

cluding petitioner herein [10] and the Department of Justice,[11] objected to permitting bank holding companies or their subsidiaries to advise *open-end* investment companies.

In response to these comments, the Board supplemented its regulation with a simultaneously issued interpretive ruling. 12 C.F.R. § 225.125, 37 Fed. Reg. 1464 (1972). The Board concluded that the provisions of the Glass-Steagall Act, particularly as interpreted by the Supreme Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971),[12] prohibited bank holding companies from sponsoring, organizing, or controlling (hereinafter, "operating") *open-end* investment companies. 12 C.F.R. § 225.125

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[10] JA at A-4, A-26.

[11] Record at 86-97. The Department of Justice lauded the "pro-competitive" aspects of the proposal, but warned the Board that the limitations imposed by § 20 of the Glass-Steagall Act, 12 U.S.C. § 377, might prohibit bank holding companies from offering adviser services to mutual funds.

[12] The *Camp* case held that sections 16 and 21 of the Glass-Steagall Act prohibited a national bank from selling interests in a "commingled investment account"—the functional equivalent of an open-end investment company. The fund at issue in *Camp* was apparently not set up as a separate corporation from the bank itself. Petitioner argued to the Board that, because of the dominance usually exerted over the fund by the adviser, *see* note 7 and accompanying text, *supra*, the reasoning of the *Camp* case was equally applicable in the more common situation in which the fund and its adviser were separate corporate entities. The Board implicitly accepted this argument. 12 C.F.R. §§ 225.125(e), (f).

(f).[13] Because of their lower level of securities activity, however, *see* note 9 and accompanying text *supra*, the Board found that *closed-end* investment companies are not subject to these prohibitions "so long as [they] are not primarily or frequently engaged in the issuance, sale, and distribution of securities." 12 C.F.R. § 225.125(f).

The interpretive ruling imposed a number of other restrictions on investment advisory activities by bank holding companies. These limitations were designed, generally, to prevent association in the public mind of the investment company and the bank holding company, *see* 12 C.F.R. §§ 225.125(f), .125(h); to forbid the bank holding company's subsidiary bank from extending credit to the investment company, purchasing, selling or distributing its shares, or accepting its securities as collateral for a loan to purchase other of its securities, *see* 12 C.F.R. §§ 225.125(g), .125(h); and to prohibit unfair sales practices di-

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[13] The Board found, however, that bank holding companies could act as investment advisers to mutual funds so long as they did not sponsor, organize or control them. *See* 12 C.F.R. §§ 225.125(d), (e), (f). This would appear tantamount to a finding that bank holding companies may at least render *advice* to an affiliated mutual fund. Petitioner challenged even this limited authorization before the Board, *see* JA at A-13-16, but has not renewed that argument on judicial review, apparently because its objections were satisfied by certain additional safeguards provided by the Board in its interpretive ruling, *see* note 14 and accompanying text *infra*.

rected towards customers of the bank subsidiary, *see* 12 C.F.R. § 225.125(h).[14]

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[14] The relevant portions of the intrepretive ruling are as follows:

> (f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. In no case, however, should a bank holding company act as investment adviser to an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.
>
> (g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not (1) purchase for their own account securities of any investment company for which the bank holding company acts as investment adviser; (2) purchase in their sole discretion, any such securities in a fiduciary capacity (including as managing agent); (3) extend credit to any such investment company; or (4) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.
>
> (h) A bank holding company should not engage, directly, [*sic*] in the sale or distribution of securities of any investment company for which it acts as investment adviser. Prospectuses or sales literature should not be distributed by the holding company, nor should any such literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regard-

After an initial jurisdictional misstep,[15] petitioner brought this challenge to an order of the Board re-

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ing any investment company for which the bank holding company acts as investment adviser may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor. Further, a bank holding company should not act as investment adviser to a mutual fund which has offices in any building which is likely to be identified in the public's mind with the bank holding company.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

[15] Petitioner, after the Board denied its petition for reconsideration and rescission, originally brought suit in the District Court requesting an injunction and a declaratory judgment that the challenged action was unlawful. The District Court dismissed the complaint on the ground that the sole forum for judicial review was the Court of Appeals. Investment Co. Inst. v. Board of Governors, 398 F. Supp. 725 (D.D.C. 1975). This court upheld the District Court's ruling. Investment Co. Inst. v. Board of Governors, 551 F.2d 1270 (D.C. Cir. 1977). Petitioner thereupon filed a second petition for reconsideration and rescission which the Board once again denied. Order Rejecting Petition of Investment Company Institute for Reconsideration and Recision [*sic*] of a Regulation by the Board, 12 C.F.R. § 225.4(a)(5)(ii), effective August 31, 1977, JA at A-169. It is this order that is under review in the present proceeding.

jecting its petition for reconsideration and rescission of 12 C.F.R. § 225.4(a)(5)(ii).[16] The case presents a variation on a recurring theme in modern banking law: the tension between federal regulatory statutes designed in part to limit bank activities, and attempts by banks—often sanctioned by federal banking authorities—to compete in broader lines of business.[17] To

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[16] The case has been the subject of considerable scholarly interest. *See, e.g.*, R. JENNINGS & H. MARSH, SECURITIES REGULATION 1351-52 (4th ed. 1977); J. WHITE, BANKING LAW 375-82 (1976).

[17] Aided by a series of liberal interpretations by the Comptroller of the Currency, national banks sought in the 1960's to expand the range of their activities in-house. These efforts, however, were largely undone by various court rulings restrictively interpreting the powers of national banks under the National Bank Act. *See, e.g.*, Investment Co. Inst. v. Camp, 401 U.S. 617 (1971); First Nat'l Bank v. Dickinson, 396 U.S. 122 (1969); Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972); National Retailers Corp. v. Valley Nat'l Bank, 411 F. Supp. 308 (D. Ariz. 1976); Georgia Ass'n of Indep. Ins. Agents, Inc. v. Saxon, 268 F. Supp. 236 (N.D. Ga. 1967), *aff'd*, 399 F.2d 1010 (5th Cir. 1968); Baker, Watts & Co. v. Saxon, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom.* Port of New York Auth. v. Baker, Watts & Co., 392 F.2d 497 (D.C. Cir. 1968). *But see* M & M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978). Banks have more recently turned to the holding company device, seeking to expand by means of non-bank subsidiaries of the holding company into new fields such as insurance, Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978), courier services, National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975), or travel agencies, Association of Bank Travel Bureaus, Inc. v. Board of Governors, 568 F.2d 549 (7th Cir. 1978). *See* J. White, *supra* note 16, at 299.

our knowledge, it is the first case in which a court has been asked to determine the permissibility of activities in the *securities* area by bank holding companies and their non-bank subsidiaries.

II

Respondent argues, as a threshold matter, that petitioner lacks standing to bring this suit. In the field of banking legislation, however, Congress has evidenced its concern to give broad rights of judicial review to parties alleging competitive injury as a result of decisions by federal banking authorities. Thus, the Supreme Court has found standing in parties challenging regulations by the Comptroller of the Currency authorizing national banks to enter into competitive lines of business. *Investment Company Institute* v. *Camp*, 401 U.S. 617, 620-21 (1971); *Association of Data Processing Service Organizations, Inc.* v. *Camp*, 397 U.S. 150, 152-56 (1970).

The same congressional concern to grant rights of judicial review to competitors is present when challenge is made to a decision of the Federal Reserve's Board of Governors. Section 9 of the Bank Holding Company Act provides that "[a]ny party aggrieved by an order of the Board" is entitled to judicial review thereof. 12 U.S.C. § 1848. Congress unambiguously demonstrated its intent that standing be liberally granted in a 1970 amendment to the Act that further defined the class of parties aggrieved to include those who would become competitors as a

result of a bank holding company's entering a nonbanking business pursuant to order of the Board. 12 U.S.C. § 1850. As noted in the Conference Committee Report to the 1970 Amendments, the purpose of this provision is to guarantee a "properly liberal attitude concerning the right of competitors of banks and bank holding companies to have standing" such that "the broadest possible forum [is] allowed for adversary proceedings to take place in order that all issues may be aired completely." H.R. REP. No. 1747, 91st Cong., 2d Sess. 29, 30 (1970) [hereinafter cited as 1970 CONF. REP.].

We have no doubt that, in the context of such strongly expressed congressional intent, the irreducible constitutional minima in the standing doctrine are satisfied in this case. It is settled that an organization has standing to sue on behalf of its injured members. *Warth* v. *Seldin*, 422 U.S. 490, 511 (1975); *Sierra Club* v. *Morton*, 405 U.S. 727, 734-41 (1972). Petitioner alleged before the District Court, in an earlier stage of this controversy, *see* note 15 *supra*, that the Board's regulation

> will subject the Institute's investment company members to illegal competition, will deprive them of legitimate business, and will dilute, divert and withdraw a substantial portion of the potential market for securities of investment companies to the substantial and irreparable injury of such members of the Institute and their shareholders. . . .

JA at A-78. Moreover, the injuries alleged are not merely "speculative," *see Simon* v. *Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 42 (1976). Petitioner alleges that, as a result of § 225.4(a)(5)(ii), many bank holding companies or their subsidiaries are actively engaged in the operation of closed-end investment companies to the detriment of its members. We conclude, then, that petitioner has standing to bring this action.

III

A.

Petitioner first argues that the Board's order and interpretive ruling authorize conduct in violation of section 21 of the Glass-Steagall Act, *as amended*, 12 U.S.C. § 378. Section 21 provides, in pertinent part, that it is unlawful

> For any person, firm, corporation association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

Petitioner bases its argument largely on *Investment Company Institute* v. *Camp*, *supra*. It contends that

although *Camp* involved a *national bank's* operation of an *open-end* company, that case's analysis of section 21 is equally applicable to a *bank holding company's* operation of a *closed-end* company.

The Board, for its part, counters with two somewhat inconsistent contentions. First, it observes that while open-end companies are continuously buying and selling their shares, closed-end companies typically issue their shares only in their initial offering and at infrequent intervals thereafter. It notes that even closed-end companies are not within the regulation if they are "primarily or frequently" engaged in the issuance, sale and distribution of securities, 12 C.F.R. § 225.125(f), and notes further that the interpretive ruling prohibits a bank holding company from any involvement in the public sale or distribution of the securities. 12 C.F.R. § 225.125(h). Stated in statutory terms, the Board's first argument is that an investment adviser may, under the limitations contained in its interpretive ruling, operate a closed-end company without engaging in the "*business* of issuing, underwriting, selling, or distributing" the securities of that company. Although the Board's argument in this regard appears at least superficially plausible, we need not decide here whether the weight it gives the distinction between closed- and open-end companies is rationally based in the evidence of record, or whether its interpretation of section 21 of the Act, as applied to these facts, is sustainable in light of the deference owed to the Board's construction of

federal banking statutes. For we find a clearer ground of decision in the Board's second argument.

This second argument is based both on the literal language of section 21 and on the structure of the Glass-Steagall Act as a whole. Section 21 in terms applies only to entities that are "engaged in the [securities] business" *and* "engaged at the same time to any extent whatever" in the commercial banking business. The Board contends that, even if a closed-end fund's investment adviser is engaged in the securities business, it is not subject to section 21 because it performs no commercial banking functions.[18]

Petitioner's response is that other subsidiaries of the bank holding company *are* engaged in commercial banking, and that in view of the Glass-Steagall Act's "prophylactic" goal, *ICI* v. *Camp*, *supra*, 401 U.S. at 639, of separating investment from commercial banking, all elements in the bank holding company structure should be considered a "single entity" for pur-

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[18] This argument would appear somewhat inconsistent with the previous one, and with the Board's interpretive ruling, because if the argument is accepted the Board would have no need to distinguish closed- and open-end companies. That is, if bank holding companies are not "engaged in" commercial banking, then it would be perfectly permissible, under section 21, for a bank holding company to operate an open-end investment company—activity that the Board has concluded would violate the Glass-Steagall Act. We do not think, however, that the Board's interpretive ruling is irrational because of this fact. Given the vagaries of judicial review, the Board was entitled to shape its action to insure against judicial reversal even if in doing so it adopted somewhat inconsistent positions.

poses of section 21. Stated another way, petitioner's argument is that the holding company and all of its subsidiaries fall within the terms of "any person, firm, corporation, association, business trust, or other similar organization" subject to section 21.

While we agree that the purposes of the Glass-Steagall Act are fully broad enough to encompass the activities of bank holding companies and their non-bank subsidiaries, *see* text accompanying note 31 *infra*, these broad purposes fail to advance petitioner's argument. The list of entities subject to section 21 conspicuously omits reference to distinct corporations related by ownership interests, and it is unlikely that Congress intended the inclusive phrase "other *similar* organization" to extend this far.

This inference is powerfully supported by the structure of the Glass-Steagall Act, which as originally enacted divided bank-related activities into three categories. First, Congress prohibited any organization from engaging *in-house* in both commercial banking and securities activities. In this category fell section 21, which was designed to prohibit the great investment banking houses from engaging in deposit banking.[19] Second, Congress sought to divorce

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[19] That Section 21 was intended to apply to in-house activities only is clear from the following colloquy between Senator Glass, co-sponsor of the bill, and Senator Robinson:

> Sen. Glass: . . . Here we prohibit the large private banks, whose chief business is investment business, from receiving deposits. We separate them from the deposit banking business.
>
> . . . .

[Footnote continued on page 18a]

commercial banks from affiliated securities firms. Ownership or control of securities affiliates was forbidden to national banks and state banks that were members of the Federal Reserve System (state member banks) by section 20 of the Act, 48 Stat. 188, *codified as amended*, 12 U.S.C. § 377.[20] Interlocking

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[19] [Continued]

Sen. Robinson: *That means if they wish to receive deposits they must have separate institutions for that purpose?*

Sen. Glass: *Yes.*

77 Cong. Rec. 3730 (1933) (emphasis supplied). *See also id.* at 4180 (Remarks of Sen. Bulkley).

Also falling in this category is § 16 of the Act, *set forth* at text accompanying note 23 *infra*. Section 16 was designed to deal with the converse situation from § 21: while § 21 prohibited investment banks from engaging in commercial banking, § 16 prohibited commercial banks subject to the Act from carrying on securities activities.

[20] As enacted, § 20 provided in pertinent part that

> no member bank shall be affiliated in any manner described in section 2(b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities.

Section 2(b) of the Act, 48 Stat. 162, *codified* at 12 U.S.C. § 221a, defined "affiliate" to

> include any corporation, business trust, association, or other similar organization—
>
> (1) Of which a memebr bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding

managements between national or state member banks and securities firms were forbidden by section 32 of the Act, 48 Stat. 194, *codified as amended*, 12 U.S.C. § 78 (1976).[21] Third, Congress sought to divorce as far as possible bank holding companies from their subsidiaries which carried on securities activities. These securities subsidiaries were forbidden, under section 19(e) of the Act, 48 Stat. 188, *repealed in pertinent part*, 80 Stat. 242-43, to any bank holding

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election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or

(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

(3) of which a majority of its directors, trustees, or other persons exercising similar function are directors of any one member bank.

[21] As enacted, § 32 provided in pertinent part that

no officer or director of any member bank shall be an officer, director, or manager of any corporation, partnership, or unincorporated association engaged primarily in the business of purchasing, selling, or negotiating securities . . . .

48 Stat. 194.

The coverage of § 20 and § 32 was, and is, not perfectly congruent; while § 20 applies to affiliates "engaged principally" in the investment business, the coverage of § 32 is somewhat broader and extends to entities "engaged primarily" in securities dealings. Board of Governors v. Agnew, 329 U.S. 441, 448 (1947).

company that wished to vote its shares of a national or state member bank.[22]

This tripartite structure, in our view, is convincing evidence that Congress rejected a "single entity" theory in favor of a more discriminating approach to the problem. *See also Board of Governors* v. *Agnew*, 329 U.S. 441, 448 (1947). Congress, in the Glass-Steagall Act, did indeed intend to regulate the activities of

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[22] Section 19(e) provided that holding company affiliates could not vote their shares unless they agreed not to own, control, or have any interest in a "securities company," defined as

> any corporation, business trust, association or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort. . . .

48 Stat. 188. This provision was made applicable to state member banks by § 5 of the Act, 48 Stat. 166, *repealed*, 80 Stat. 243.

"Holding company affiliate" was defined to include

> any corporation, business trust, association, or other similar organization—
>
> (1) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceeding election, or controls in any manner the election of a majority of the directors of any one bank; or
>
> (2) For the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

Section 2(c) of the Act, 48 Stat. 163, *repealed*, 80 Stat. 242. *Compare* the definition of "affiliate" in note 20 *supra*.

bank holding companies and their non-bank subsidiaries—but *not* in section 21 of the Act. Because we conclude that section 21 was intended to apply to in-house activities only, we find that it is not violated by the Board's regulation and interpretive ruling challenged herein.

B.

Petitioner challenges the Board's action, alternatively, as being inconsistent with section 16 of the Glass-Steagall Act, *as amended*, 12 U.S.C. § 24 (Seventh). Section 16 provides in pertinent part that

> The business of dealing in securities and stock by [a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and [a national bank] shall not underwrite any issue of securities or stock. . . . Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by [a national bank] for its own account of any shares of stock of any corporation.[23]

As to this section, petitioner concedes that only the activities of banks, and not those of other entities within the holding company structure, are within its terms. It argues, however, that national and state member banks are authorized to act as investment ad-

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[23] These limitations are made applicable to state member banks by § 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335.

visers by the following statement in the Board's interpretive ruling:

> Under § 225.5(a)(5) [*sic*], as amended, bank holding companies (*which term, as used herein, includes both their bank and nonbank subsidiaries*) may, in accordance with the provisions of § 225.4(b), act as investment advisers to various types of investment companies. . . .

12 C.F.R. § 225.125(c) (emphasis added). Such activity by national and state member banks, in petitioner's view, is directly forbidden by section 16.[24]

The Board, however, disclaims any intention of authorizing banks, as opposed to bank holding companies and their non-bank subsidiaries, to act as investment advisers. It notes that its interpretive ruling was issued pursuant to section 4(c)(8) of the Bank Holding Company Act, which authorizes activity only by bank holding companies themselves[25] or their non-bank subsidiaries. Therefore, says the Board, it did not and could not permit *banks* to engage in investment adviser activities. The reference to bank subsidiaries in the interpretive ruling, according to the Board, was designed to impose only the *restrictions* of that ruling, *see* note 14 and accompanying text *supra*, on subsidiary banks.[26]

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[24] Petitioner claims that, in reliance on this ruling, numerous national and state member banks are now acting as investment advisers to closed-end investment companies.

[25] *See* § 4(a)(2)(B) of the Bank Holding Company Act, 12 U.S.C. § 1843(a)(2)(B).

[26] The Board disputes petitioner's claim that banks have initiated investment adviser services in reliance on the Board's

Although the Board's explanation of the interpretive ruling is reasonble, it is nevertheless true that the ruling is highly susceptible to the construction urged by petitioner. While that ruling has been published in the Federal Register and the Code of Federal Regulations, the Board's disclaimer has, so far as we know, been circulated only to petitioner, JA at A-68, and to other persons who may have had occasion to read that letter or the Board's brief in this review proceeding. The publication of this opinion should serve to bring to wider public attention the Board's interpretation of the reference to bank subsidiaries in 12 C.F.R. § 225.125(c).

IV

This is, however, not the end of our inquiry. The operative phrase we are called upon to interpret is not found in the Glass-Steagall Act but rather in the Bank Holding Company Act, as amended; the precise issue before us is whether operating a closed-end investment company, under the terms of the Board's regulation and interpretive ruling, is "so closely related to banking or managing or controlling banks as to be a proper incident thereto." Section 4(c)(8)

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action, *see* note 24 *supra*. It notes that *if* banks had actually initiated such services in reliance on Regulation Y, they would have had to apply to the Board for specific approval prior to offering the service. *See, e.g.*, National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975). According to the Board, it has not received a single application for permission for a bank to engage in investment adviser services.

of the Bank Holding Company Act, *as amended*, 12 U.S.C. § 1843(c)(8). The Glass-Steagall Act is not dispositive of this question, for even if it is not violated directly, it remains possible that the Bank Holding Company Act has been contravened. At the same time, of course, the Glass-Steagall Act is not irrelevant to this inquiry; its policies may well carry forward and inform the meaning of the later statute.

We are bound to note that the Board was never forcefully presented with this argument. Petitioner did allege before the Board and at oral argument before us that the Board had authorized conduct in violation of section 4(c)(8). However, on analysis this argument can be seen to collapse for the most part into petitioner's basic contention that the Board has no authority to authorize conduct in violation of sections 16 and 21 of the Glass-Steagall Act. The Board's construction of the Bank Holding Company Act in relation to the issue before us would ordinarily be entitled to a high degree of deference, *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 513 (1978); *cf. ICI* v. *Camp, supra*, 401 U.S. at 626-27 (Comptroller of the Currency). We cannot, however, abdicate our duty in the final instance to say what the law is, *International Brotherhood of Teamsters* v. *Daniel*, 99 S.Ct. 790, 800 & n.20 (1979); *SEC* v. *Sloan*, 436 U.S. 103, 118-19 (1978). And our conclusion, based on the legislative histories of the present section 4(c)(8) and its predecessor statutes, is emphatically that section 4(c)(8) does not empower the Board to authorize conduct of the type

at issue here. In light of this conclusion, we find that the appropriate disposition is to vacate the Board's regulation and interpretive ruling rather than to remand to the agency for what would be an expensive, time-consuming, and ultimately pointless reconsideration.

A.

There have been three main episodes in the rather complex history of federal legislation aimed at regulating bank holding companies: the Glass-Steagall Act, in 1933; the Bank Holding Company Act, in 1956 (1956 Act); and the Bank Holding Company Act Amendments, in 1970 (1970 Amendments). Of course, the determinative consideration is the meaning to be attributed to section 4(c)(8) in the most recent statute. As will be seen, however, it is necessary to examine the earlier provisions in order to divine what Congress intended in 1970.

As we have noted, *see* note 22 and accompanying text *supra*, Congress addressed the problem of securities activities by bank holding companies in section 19(e) of the Glass-Steagall Act. Congress' approach to this problem differed somewhat from its treatment of securities activities by banks themselves or by their non-holding company affiliates. While in the latter situations Congress simply proscribed the activities in question, *see* notes 19-21 and accompanying texts *supra*, in the case of holding company affiliates Congress permitted the affiliation to continue, but only so long as the holding company did not vote its shares in its subsidiary bank.

This somewhat less restrictive treatment of bank holding companies did not stem from any congressional perception that the securities activities of bank holding companies or their non-bank affiliates were any less insidious than those of banks themselves or of firms with which banks were affiliated directly rather than through a holding company parent. Although the Senate hearings [27] that culminated in the Glass-Steagall Act focused primarily on the latter, direct type of securities affiliate, it is clear that the hazards identified at those hearings of affiliation between banks and securities firms were present [in] the case of holding company affiliates also.[28] As the Senate Re-

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[27] *Hearings Pursuant to S. Res. 71 before a Subcommittee of the Senate Committee on Banking and Currency*, 71st Cong., 3d Sess. (1931) [hereinafter cited as *1931 Hearings*].

[28] The hearings identified numerous abuses and unsound practices associated with bank securities activities. *See generally ICI* v. *Camp*, *supra*, 401 U.S. at 629-634. The evidence before the subcommittee showed that securities affiliates were involved in a wide variety of activities, including underwriting, wholesaling and retailing securities, holding assets for the benefit of the affiliated bank, buying and selling securities purely for speculative purposes, trading in the bank's own stock in order to "support[] the market," and holding real estate assets. *1931 Hearings*, *supra* note 27, at 1057. There was a danger that banks affiliated with such securities firms would make imprudent use of their own or their depositors' assets, either through direct investment in the securities affiliate or its portfolio or through making unsound loans to it. There was the possibility that a bank's promotional interest in its securities affiliate might cause it to lend its reputation for financial prudence to the affiliate, *see id.* at 1063; *ICI* v. *Camp*, *supra*, 401 U.S. at 631; might distort the bank's credit policies, *see 1931 Hearings*, *supra* note 27, at 87, 1064; *see*

port on the bill that became the Glass-Steagall Act noted, "[t]he evils of indirect control are similar in the two cases, and they may lead to similar abuses, as is seen when it is noted that holding companies also usually control companies organized for security financing." 1933 S. REP., *supra* note 28, at 10. The different treatment for holding company affiliates stemmed solely from a congressional concern that, under the commerce clause as then restrictively interpreted, Congress did not have power to force a state-

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also S. REP. NO. 77, 73d Cong., 1st Sess. 9-10 (1933) [hereinafter cited as 1933 S. REP.]; and might cause the bank to disregard its fiduciary duty to its shareholders, *see 1931 Hearings, supra* note 27, at 266, 1064; *see also* 75 CONG. REC. 9912 (1933) (remarks of Sen. Bulkley). Further, it was felt that the relation between bank and affiliate mutually reinforced unduly risky investment policies: the banks knew that their unwise investments could be shifted to the affiliate while the affiliates knew that in case of need they had a ready source of funds in the bank. *1931 Hearings, supra* note 27, at 1064. There was also the danger that poor performance of the securities affiliate would cause a loss of public confidence in the bank, *id.* at 1063-64; *see* 77 CONG. REC. 3835 (1933) (remarks of Rep. Steagall). In the words of Senator Glass, 75 CONG. REC. 9887 (1933),

> The committee ascertained . . . that one of the greatest contributions to the unprecedented disaster which has caused this almost incurable depression was made by these bank affiliates. They sent out their high-pressure salesmen and literally filled the bank portfolios of this country with these investment securities. They actually dealt in the stocks of the parent bank. . . . They were organized to evade the law.

chartered bank holding company to divest itself of a state-chartered securities affiliate.[29]

Section 19(e) of the Glass-Steagall Act applied only to entities "formed for the purpose of, or engaged principally in" the securities business. *See* note 22 *supra*. It is now too late to know whether this language would have encompassed a bank holding company's operation of a closed-end investment company under the limitations of the Board's interpretive ruling.[30] What is important for our purposes, however, is not what the specific language in the Glass-Steagal Act would have meant, but, rather, what subsequent Congresses *thought* that Act to have meant. And as to this question there is little doubt. The broad purpose of the Glass-Steagall Act, and most importantly the effect of the Act *as viewed by*

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[29] In the words of the Senate Committee:

> Since the companies are State corporations, Congress has no control over them, except that which may be voluntarily granted. However, since the staple of their ownership or holdings is the stock of National and State member banks, it would seem that Congress may control the conditions under which such stocks may be owned and particularly voted.

1933 S. REP., *supra* note 28, at 10.

[30] There is indirect evidence that at least the industry viewed the Glass-Steagall Act as broadly prohibiting such activity. *See* Securities & Exch. Comm'n, *Report to Congress on Investment Trusts and Investment Companies*, H.R. Doc. 70, 76th Cong., 1st Sess. 59 (1939) ("The most striking changes in the sponsorship of closed-end companies within the period 1929 and 1935 were the disappearance of national bank securities affiliates as sponsors because of the abolition of such affiliates by the [Glass-Steagall Act].").

later Congresses, was to divorce completely investment from commercial banking, to "separate as far as possible national and member banks from affiliates of all kinds." [31]

B.

The holding company provisions of the Glass-Steagall Act, including section 19(e), applied only if the subsidiary bank was a member of the Federal Reserve System and the holding company sought to exercise control by actually voting its shares. These limitations ultimately became a major loophole in the Act that permitted bank holding companies to acquire a wide variety of nonbanking subsidiaries.[32] Congress sought to rectify the situation in the Bank Holding Company Act by requiring holding companies (defined to include companies controlling nonmember banks) to divest themselves of their nonbanking businesses. Section 4(a) of the 1956 Act, *as amended*, 12 U.S.C. § 1843(a). However, the 1956 Act provided a series of specific exemptions from this requirement, including the predecessor of the one rele-

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[31] 1933 S. REP., *supra* note 28, at 10; *see also* 77 CONG. REC. 3835 (1933) (remarks of Rep. Steagall).

[32] See Board of Governors v. First Lincolnwood Corp., 99 S.Ct. 505, 511 (1978); H.R. REP. No. 609, 84th Cong., 1st Sess. 9 (1955) [hereinafter cited as 1955 H.R. REP.]

Although this loophole apparently would have permitted bank holding companies to acquire *securities* subsidiaries, Congress was unaware of any such acquisitions. This is further evidence that the financial community viewed the Glass-Steagall Act as having completely divorced the functions of commercial and investment banking.

vant here, section 4(c)(6) of the Act, 70 Stat. 137. In pertinent part, this provision exempted

> shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board . . . has determined to be *so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto* and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act (emphasis added).

Although the legislative history provides virtually no guidance as to the meaning of this phrase,[33] it would appear that Congress did not intend the exemption to be so broad as to cover shares of an investment adviser operating a closed-end investment company. The 1956 Act, as we have noted, was a loophole-closing law designed to further the Glass-Steagall Act's overarching policy, *see* text accompanying note 31 *supra*, of divorcing investment from commercial banking.[34] There is no doubt that the Glass-Steagall Act was designed to separate banks from investment subsidiaries of their holding company affiliates. We

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[33] *See* National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975).

[34] *See* 1955 H.R. REP., *supra* note 32, at 16; S. REP. NO. 1095, 84th Cong., 1st Sess. 1, 2 (1955) [hereinafter cited as 1955 S. REP.]. *See also* S. REP. NO. 1179, 89th Cong., 2d Sess. 2 (1966) [hereinafter cited as 1966 S. REP.] (1956 Act was intended to apply "the general purposes of the Glass-Steagall Act of 1933—to prevent unduly extensive connections between banking and other businesses.").

cannot lightly infer that the 1956 Congress intended, *sub silentio*, to undermine what it perceived as a fundamental policy of a law that it was attempting to supplement and strengthen.

Such legislative history as exists supports the view that the Board's discretion in applying this exemption was to be a narrow one. Board Chairman William McChesney Martin reported to both the Senate and House Committees that the Board's authority to exempt shares of closely related businesses was to be "limited." [35] The examples given of activities that obviously fell within this exception were extremely narrow, and did not include any securities related activities.[36] Despite the narrowness of this discretion, the House Committee refused to report the provision.[37] When the House acceded to the Senate version con-

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[35] *See Control and Regulation of Bank Holding Companies: Hearings on H.R. 2674 Before the House Comm. on Banking and Currency*, 84th Cong., 1st Sess. 14 (1955); *Control of Bank Holding Companies: Hearings on S. 880, S. 2350, and H.R. 6227 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 84th Cong., 1st Sess. 76 (1955) [hereinafter cited at *1955 Senate Hearings*].

In another context of the same hearings, Chairman Martin said that "I would like to have [as] little discretionary authority as I can have." *1955 Senate Hearings, supra*, at 47.

[36] The Senate Committee reported that obviously exempt activities might include "operation of a credit life-insurance program in connection with bank loans" and "an insurance program under which the insurance proceeds retire the outstanding balance of the mortgage upon the death of the mortgagor in cases where the bank holds the mortgage." 1955 S. REP., *supra* note 32, at 13.

[37] 1955 H.R. REP., *supra* note 29, at 16.

taining the exemption, it was with the explicit assurance on the part of the Chairman of the House Committee that the Senate amendments did not make any "material change" [38] in the legislation as it passed the House. In light of this assurance, it is difficult to believe that the House felt that it was agreeing to a grant of discretion to the Board so sweeping as to cut back on the prohibitions of the Glass-Steagall Act.

Our conclusion that the 1956 Act was in all probability not intended to permit bank holding company operation of a closed-end investment company is supported by the subsequent repeal of section 19(e) of the Glass-Steagall Act, the provision that required holding companies wishing to vote their bank's shares to divest themselves of their securities subsidiaries.[39] The Senate Report, commenting on the repeal, noted that section 19(e) "*serve[d] no substantial purpose*" after passage of the 1956 Act.[40]

C.

The question then becomes whether the 1970 Amendments to the 1956 Act had the effect of enlarging the Board's authority to the degree contemplated by its regulation and interpretive ruling. The principal purpose of the 1970 Amendments was to prevent one-bank holding companies—which had been exempt

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[38] 102 CONG. REC. 7165 (1956) (remarks of Rep. Spence).

[39] Section 13(c) of the Bank Holding Company Act Amendments of 1966, 80 Stat. 242-43 (1966).

[40] 1966 S. REP., *supra* note 34, at 12 (emphasis added).

from the provisions of the 1956 Act—from entering businesses not related to banking.[41] *Board of Governors* v. *First Lincolnwood Corp.*, 99 S.Ct. 505, 512-513 (1978). A second and far more controversial purpose for the Amendments, urged by the Nixon Administration and by Federal Reserve officials, was to broaden the variety of enterprises in which bank holding companies could engage. Supporters of this liberalization argued that it would stimulate competition and create economies of scale, to the benefit of the consumer, and would permit banks to adjust flexibly to a dynamic economy.[42] On this goal the House and Senate disagreed; the struggle between them culminated in the rewriting of the bill during a Conference Committee "of great controversy and grinding negotiations and many, many offers and

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[41] In the late 1960's, this exemption suddenly began to be used as a means by which single banks could join by merger into a conglomerate structure involving various non-banking businesses. There was a widespread belief in Congress that this loophole had to be closed quickly in order to curb the rapid centralization of American industry into a few gigantic accretions of capital. *See generally*, H.R. REP. No. 387, 91st Cong., 1st Sess. 2 (1969) [hereinafter cited as 1969 H.R. REP.]; S. REP. No. 1084, 91st Cong., 2d Sess. 3-4 (1970) [hereinafter cited as 1970 S. REP.].

[42] *See Bank Holding Company Act Amendments—Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. 86, 88, 198 (1969) [hereinafter cited as *1969 House Hearings*]; *One Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 147, 169, 187 (1970) [hereinafter cited as *1970 Senate Hearings*].

counter offers in an attempt to reach agreement." [43] The product was the type of ambiguous compromise that characteristically results when parties who deeply disagree are under intense pressure to reach a mutually acceptable accommodation.

Section 4(c)(8), as amended, exempts

> shares of any company the activities of which the Board . . . has determined . . . to be *so closely related to banking or managing or controlling banks as to be a proper incident thereto.* . . .

12 U.S.C. § 1843(c)(8) (emphasis added). This language reflects concessions by both the House and Senate conferees. The Senate conferees agreed to retain the "closely related" language of the 1956 Act. The majority House conferees, as relevant to our inquiry, agreed to amend the 1956 Act's phrase "the business of banking" to read simply "banking," and agreed to delete a so-called "laundry list" of activities generally forbidden to bank holding companies.

Both the House and Senate bills, as reported, replaced the "closely related" language with a "functionally related" test.[44] This language had been proposed by Chairman Martin during the House Committee hearings, apparently as a compromise between the Administration's bill, which would have dramatically broadened the activities permitted bank holding

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[43] 116 CONG. REC. 41963 (1970) (remarks of Rep. Sullivan).

[44] 1969 H.R. REP., *supra* note 41, at 1; 1970 S. REP., *supra* note 41, at 25.

companies,[45] and Representative Patman's bill, which would have retained verbatim the standard of the 1956 Act.[46] As defined by Chairman Martin and his successor, Chairman Arthur Burns, the "functionally related" test would have been broad enough to encompass operating a closed-end investment company.[47] Despite the fact that both Houses passed bills containing the "functionally related" test, the Conference Committee returned to the "closely related" test of the 1956 Act.[48]

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[45] The Administration proposed to exempt shares of companies whose activities were "financial or related to finance in nature or of a fiduciary or insurance nature." 1970 CONF. REP., *supra*, at 19.

[46] *See 1969 House Hearings, supra* note 42, at 164.

[47] Chairman Martin's statement, *id.* at 220 (emphasis supplied), listed as a permissible activity "operating a diversified *open-end* investment company"; but given the lower level of securities activities by closed-end companies, *see* text following note 8 *supra*, the statement would appear to apply *a fortiori* to the latter. Chairman Burns listed within the "functionally related" rubric "acting as investment adviser [or] operating a 'no load' mutual fund." *1970 Senate Hearings, supra* note 13, at 142.

[48] 1970 CONF. REP., *supra*, at 5. This action reflected a compromise between the House and Senate bills. The House bill, although it incorporated the "functionally related" test, had been amended on the floor to include a "laundry list" of six activities generally forbidden to bank holding companies. *See* 115 CONG. REC. 33133-33139 (1969). The majority conferees from the House agreed, *inter alia*, to eliminate the laundry list, but only in exchange for a return to the existing "closely related" standard. *See* 116 CONG. REC. 42423 (1970) (remarks of Sen. Sparkman); *id.* at 41954 (remarks of Rep. Widnall.) The significance of the concessions by the House conferees is discussed at text accompanying notes 52-63 *infra*.

The precise significance of the retention of "closely related" is unclear. The four majority House conferees gave it great significance,[49] but the three minority House members refused to sign the statement. The Senate conferees generally downplayed its importance.[50] Courts have disagreed as to its implications.[51]

Whatever its overall significance, however, retention of the "closely related" test evidences a congressional intent that bank holding companies were not to engage in the securities business beyond what was permitted in the 1956 Act. As we have noted, the "closely related" language in the earlier statute was in all likelihood not intended to permit operation of a closed-end investment company. *See* text ac-

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[49] They argued that

> The decision of the Conferees to reject the "functionally related test" . . . is intended to be construed to mean that the Congress was not convinced that such expansion and liberalization was justified. Consequently, the Congress intends that those activities which the Board and other witnesses claim would have been permitted under the "functionally related test" . . . are not authorized by our decision to retain the "so closely related" test, which is considerably less expansive and liberal. . . .

1970 CONF. REP., *supra*, at 21.

[50] *See* 116 CONG. REC. 42422, 42424 (remarks of Sen. Sparkman); *id.* at 42427, 42435 (remarks of Sen. Bennett).

[51] *Compare* National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975) *with* Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224, 239 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978).

companying notes 33-38 *supra*. The liberalized "functionally related" language, at least as interpreted by the spokesmen for the Board, would have permitted such activity. *See* note 47 and accompanying text, *supra; but see* note 58 and accompanying text *infra*. The rejection of the proposed language, and the return to the earlier standard, strongly suggests that Congress would have intended that the activity at issue in this case not be engaged in.

The "closely related" language, however, was retained only in exchange for a number of liberalizing concessions, two of which are relevant for present purposes. First, the Conference Committee amended the phrase "the business of banking" to read simply "banking." If the meaning of this change is not obvious on its face, the underlying legislative purpose is clear. The Board sought to be freed of a number of its precedents that had restrictively interpreted this phrase to encompass only activities with a direct and significant connection to the actual business of a particular bank holding company's subsidiary bank. For example, the Board had permitted bank holding companies to own a mortgage servicing subsidiary, but had limited the subsidiary's activities to the servicing of mortgages actually held by a subsidiary bank.[52] The deletion of the qualifying phrase "the business of" was suggested to the Conference Committee by Chairman Burns as a means of permitting bank holding companies and their non-bank subsidiaries to engage in activities "related to bank-

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[52] *See 1970 Senate Hearings, supra* note 42, at 201.

ing . . . generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved." [53]

As this court has previously noted, deletion of the qualifier "the business of" significantly liberalized the strictures of section 4(c)(8).[54] Nevertheless, this change, as interpreted by its principal proponent, was designed only to permit bank holding companies and their non-bank subsidiaries to enter *markets* not served by their bank subsidiaries.[55] Nowhere was it suggested that the amendment was intended to broaden the *lines of business* permitted to bank holding companies.[56] As we have seen, however, as of 1970 Congress probably believed, with good reason, that bank holding companies could not legally operate closed-end investment companies.[57] It appears, therefore, that this particular change did not make legiti-

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[53] 116 CONG. REC. 41959 (1970).

[54] National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1236 (D.C.Cir. 1975). *But see* Alabama Ass'n of Ins. Agents v. Board of Governors, 533 F.2d 224 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978).

[55] 116 CONG. REC. 41959 (1970) (letter from Chairman Burns).

[56] Chairman Burns' suggestion was clearly a fallback position, a statement of the minimum liberalization he would be willing to accept. In this context, it would seem incongruous to interpret the amendment so expansively as to go significantly beyond the effect claimed for it by its author and chief proponent.

[57] *See* text accompanying notes 33-38 *supra*.

mate the activities sanctioned by the Board's regulation and interpretive ruling.

A second liberalizing action by the Conference Committee was the elimination of the House bill's so-called "laundry list" of activities that bank holding companies could engage in either not at all or to a very limited extent only. One item on this list encompassed the operation of closed-end investment companies, *see* text accompanying note 60, *infra*. At first blush, then, it might appear that Congress' elimination of this prohibition constituted a specific endorsement of the Board's action challenged in this case.

The legislative history, however, tells a far different story. As was evident from our review of the Glass-Steagall Act, the abuses stemming from bank involvement in the *securities* business were the very evils against which that legislation was primarily aimed. Not surprisingly, then, although the meaning of section 4(c)(8) may be controversial in other respects, the evidence is overwhelming that Congress did not intend that provision to cut back on the prohibitions against securities activities contained in the Glass-Steagall Act.

Apparently the only participants in the legislative process even to suggest that bank holding companies might be permitted to act as investment advisers were Chairmen Martin and Burns, the spokesmen for the Board. Significantly, however, even the Nixon Administration's bills, which would have greatly liberalized the activities permitted bank holding companies in other respects, contained an explicit prohibition,

in terms nearly identical to section 19(e) of the Glass-Steagall Act, against entry into the securities business by bank holding companies.[58]

The House bill, as reported, forbade bank holding companies from acquiring the shares of any company "engaging in the underwriting, public sale, or distribution of mutual funds."[59] This provision was not stringent enough for the full House, which amended it on the floor to cover

> [e]ngaging in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds or other similar securities, or of interests in any such securities, whether or not any such interests are redeemable and whether or not the securities to which any such interests relate are in a fund or account or are subject to discretionary sale or purchase. . . .[60]

The floor amendment was incorporated as part of the laundry list that was eliminated in Conference Committee.

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[58] The Administration bills in both Houses would have barred holding companies from obtaining interests in companies "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities." *See 1970 Senate Hearings, supra* note 42, at 98 (S.1664); *1969 House Hearings, supra* note 42, at 90, 175, 418, 549 (H.R. 9385).

[59] *See* 115 CONG. REC. 32910 (1969) (H.R. 6778).

[60] *See id.* at 33133, 33139.

Its elimination, however, did not signal its rejection by the Conferees; to the contrary, this particular part of the laundry list was *supported* by the Nixon Administration. In the words of Dr. Charls Walker, Under Secretary of the Treasury: [61]

> We could have lived with [the "functionally related"] language. Unfortunately, on the floor of the House, they went on to say that certain activities are not functionally related to banking —*one we would agree with to be excluded, the securities business. This has been traditional for years*—but listed some five or more other areas where banks already are operating and have been operating for many, many years.

During the same hearings, Dr. Walker amplified this position with specific reference to investment adviser activities: [62]

> THE CHAIRMAN [Sen. Sparkman]: During the 90th and the 91st Congresses, this committee sent to the Senate floor legislation which in both instances was adopted, allowing banks to offer commingled managed agency accounts. These are bank-operated mutual funds, which are sold without a sales charge.
>
> The House-passed one bank holding company bill would, in [Sen. Williams'] opinion, specifically prohibit such sales by holding companies.
>
> In your opinion, is such a prohibition justified? What is the Treasury Department's view

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[61] 1970 *Senate Hearings, supra* note 42, at 18 (emphasis added).

[62] *Id.* at 27 (emphasis added).

on the desirability of allowing banks to offer these mutual funds to the public?

Dr. WALKER: The Treasury Department has supported the legislation to which Sen. Williams referred . . . permitting banks in-house, the bank, to operate mutual funds. *We have not supported legislation which would allow bank affiliates to operate mutual funds, nor would this legislation change present law in that respect.*

This particular part of the laundry list was eliminated, not because the Conferees found it objectionable, but only because it was felt to be unnecessary in light of existing prohibitions in the Glass-Steagall Act. This is evident from the following colloquy, 116 CONG. REC. 42430 (1970):

Mr. WILLIAMS of New Jersey. I have one question I should like to ask the chairman of the committee.

Both the Senate and House bills contained, in section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides, essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affliates.

Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly pro-

> hibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here. We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. The provision to which you referred is already complicated enough. In short, we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act. If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation. I hope there is no longer any misconception on that point.
>
> Mr. WILLIAMS of New Jersey. It is reassurring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so.

We do not view this colloquy as casting doubt on our conclusion in Part III hereof that sections 16 and 21 of the Glass-Steagall Act do not proscribe operation of closed-end funds by bank holding companies. Most importantly, the Senators' assumption that the Glass-Steagall Act barred securities activities by bank holding companies was in all likelihood based on section 19(e) of the Act, *see* note 22 *supra*, or possibly, on the securities affiliate provisions of sections 20 and 32, *see* notes 20-21 *supra*. Section 19(e), of course, was repealed in 1966, *see* notes 39-40 and accom-

panying text *supra;* and, needless to say, we intimate no views as to the applicability to the present case of sections 20 and 32.

Further, this colloquy is significant, not so much for what it says about the Glass-Steagall Act, but for what it implies about the 1970 Amendments to the Bank Holding Company Act. The quoted passage indicates that Congress *perceived* the Glass-Steagall Act as prohibiting securities activities by bank holding companies and their non-bank subsidiaries. Congress, of course, may have been mistaken in its perception, but this possibility has no bearing on its intent in amending section 4(c)(8) of the Bank Holding Company Act. And, as we have noted, Congress did not intend, in the 1970 Amendments, to sanction bank holding company operation of closed-end investment companies.[63]

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[63] Some of the statements in the legislative history refer to a "mutual fund", which is the popular name for an open-end investment company. It would appear, however, that the phrase was used in a rough generic sense to refer to investment companies of all kinds, rather than to open-end companies as opposed from closed-end ones. The generic usage undoubtedly stemmed from Congress' awareness of efforts on the part of national banks during that period to operate mutual funds directly. *See 1970 Senate Hearings, supra* note 42, at 27; 115 CONG REC. 32897 (1969) (remarks of Rep. Patman); *cf. ICI* v. *Camp, supra.* That closed-end companies were not meant to be excluded is evident from the House's floor amendment, *see text* accompanying note 60 *supra,* which explicitly covered "interests in . . . securities, *whether or not any such interests are redeemable. . . .*" *See also* 115 CONG. REC. 32902 (1969) (remarks of Rep. Moorhead).

Our analysis of the legislative history of section 4(c)(8) is further supported by a consideration of the policies underlying the 1970 Amendments. As we have noted, *see* text accompanying note 41 *supra*, the main thrust of this legislation was to close the one-bank holding company loophole. The burgeoning of one-bank holding companies was thought to pose two somewhat different dangers.

First, there was the danger that bank holding companies would improperly further the interests of their nonbank subsidiaries by abusing the power of their subsidiary banks.[64] Although to a considerable extent the Board's interpretive ruling reduces the likelihood of these abuses, *see* note 14 and accompanying text, *supra*, a number of evils foreseen by Congress in 1970 might not be fully protected against. The interpretive ruling does not prohibit a subsidiary bank from preferentially advancing credit to companies whose shares are owned by the controlled closed-end investment company, or from denying credit to the competitors of those companies.[65] Nor does it prohibit a subsidiary bank from disclosing confidential information about its depositors to its affiliated investment adviser.[66]

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[64] *See* 115 CONG. REC. 32891 (1969) (remarks of Rep. Bennett); *id.* at 32894 (remarks of Rep. Patman); *id.* at 32903 (remarks of Rep. Moorehead); *1969 House Hearings*, *supra* note 42, at 197 (testimony of Chairman Martin).

[65] *See* authorities cited in 64 *supra*.

[66] *See* 115 CONG. REC. 32894 (1969) (remarks of Rep. Patman).

More importantly, the Board's interpretive ruling fails to give due weight to a second evil that was thought to flow from the growth of one-bank holding companies: the centralization of economic power in the American economy. Congress was deeply concerned that the economy was becoming structured along the lines of the Japanese "Zaibatsu" system, in which economic power was concentrated in a few gigantic power centers.[67] This concern for the structural integrity of the economy would be present even if there were fully adequate safeguards against abuse of the subsidiary bank's economic power. Yet the Board's action in the present case, permitting bank holding companies or their affiliates to control the investment decisions for large pools of capital, would seem to portend the type of centralization of power that Congress feared in the 1970 Amendments.[68]

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[67] *See, e.g., 1970 Senate Hearings, supra* note 42, at 13; *1969 House Hearings, supra* note 42, at 9, 21.

This concern was reflected in the President's message to Congress accompanying introduction of the Administration bills:

> Left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen....

Statement by the President Endorsing Proposed Legislation for Further Regulation, 5 WEEKLY COMP. OF PRES. DOC. 461 (March 24, 1969).

[68] Apparently the only witness at the House or Senate Hearings who spoke directly to this question was Professor Adolf Berle. His testimony is instructive:

[Footnote continued on page 47a]

For the reasons stated above, we vacate the Board's regulation and interpretative ruling challenged in this case, 12 C.F.R. §§ 225.4(a)(5)(ii), 225.125.

It is so ordered.

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[68] [Continued]

> [A] one-bank holding company, with the resources of its bank, with the stockholding power in the bank's trust department, *and especially if it also acquires control of mutual funds which have further stock interests,* can probably attain control of any corporation in the country it really wants to get. . . .

1969 House Hearings, supra note 42, at 9 (emphasis supplied). Professor Berle also testified that

> [u]nquestionably, entry into the mutual investment field would mean that if the group that controlled the banks also controls the mutual investment funds, it could have a very large influence, perhaps a dominating influence, on the stock market. The huge institutions, by buying or selling, or refusing to buy or sell, as the case might be, in substantial measure could for a time at least determine the level of the stock market.

Id. at 28.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 13, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: McGOWAN and WILKEY, Circuit Judges, and GASCH, United States District Judge for the District of Columbia.

ORDER

It is ORDERED, by the Court, *sua sponte*, that the Opinion for the Court filed in the above captioned case on March 30, 1979 be, and it hereby is amended as follows:

Add the following sentence to Footnote 13:

> Under these circumstances, we do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render

solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Mar. 30, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

PETITION FOR REVIEW OF AN ORDER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Before: McGOWAN and WILKEY, Circuit Judges, GASCH,* United States District Judge for the District of Columbia

JUDGMENT

This cause came on to be heard on a petition for review of an order of the Board of Governors of the Federal Reserve System and was argued by counsel. On consideration thereof, it is

ORDERED AND ADJUDGED by this Court that the Board's regulation and interpretative ruling challenged in this case are hereby vacated, in accordance with the opinion of this Court filed herein this date.

Per Curiam

For the Court:

/s/ George A. Fisher
Clerk

Date: March 30, 1979

GEORGE A. FISHER

Opinion for the court filed by Circuit Judge McGowan.

* Sitting by designation pursuant to 28 U.S.C. § 292(a).

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 16, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: McGowan and Wilkey, Circuit Judges; and Gasch*, Judge, United States District Judge for the District of Columbia.

ORDER

Upon consideration of respondent's (Board of Governors of the Federal Reserve System) petition for rehearing, and of petitioner's (Investment Company Institute) response thereto, it is

ORDERED, by the Court, that respondent's aforesaid petition for rehearing is denied.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

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* Sitting by designation pursuant to Title 28 U.S.C. § 292(a).

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

September Term, 1978

No. 77-1862

[Filed Jul. 16, 1979]

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

BEFORE: Wright, Chief Judge; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb, and Wilkey, Circuit Judges.

ORDER

The suggestion for rehearing *en banc* filed by respondent Board of Governors of the Federal Reserve System, and the response filed thereto by petitioner Investment Company Institute, having been transmitted to the full Court and no judge in regular active service having requested a vote with respect thereto, it is

ORDERED, by the Court, that respondent's aforesaid suggestion for rehearing *en banc* is denied.

Per Curiam

For the Court:

/s/ George A. Fisher
GEORGE A. FISHER
Clerk

APPENDIX D

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Washington, D.C. 20551

March 8, 1974

G. Duane Vieth, Esq.
Arnold & Porter
1229 Nineteenth Street, N.W.
Washington, D.C. 20036

Dear Mr. Vieth:

This is in reference to the petition dated December 12, 1973 filed by you on behalf of your client, the Investment Company Institute ("ICI"), requesting that the Board of Governors reconsider and rescind section 225.4(a)(5)(ii) of Regulation Y which authorizes bank holding companies, subject to the procedures of section 225.4(b), to serve as investment advisers, as defined in section 2(a)(20) of the Investment Company Act of 1940, to investment companies registered under that Act. The petition argues that the Board's regulation authorizes violations of two provisions of the Banking Act of 1933 (commonly referred to as the Glass-Steagall Act) and that therefore the Board acted improperly when it acted under section 4(c)(8) of the Bank Holding Company Act to permit the activity in question. The Board has considered the arguments contained in the petition and, for the reasons stated hereinafter, believes them to be without merit. Accordingly, the petition is hereby denied.

The petition alleges that there are at present 19 investment companies advised by banks and bank-affiliated institutions; these companies have sold over $1 billion in securities to the public. Of these companies, 15 are closed-end funds, three are open-end funds (participation in these three is limited to banks and other institutions) and one is technically an open-end fund but operates like a closed-end fund. Twelve of the 19 investment companies are advised by the bank subsidiaries of bank holding companies and the remainder are advised by nonbanking subsidiaries.

The principal argument contained in the petition is that section 21 of the Glass-Steagall Act (12 U.S.C. 378), which makes it a felony for a deposit-receiving institution to engage at the same time in the business of issuing, underwriting, selling or distributing stocks, bonds or other securities, is violated by the Board's regulation because "bank holding companies, their banking and nonbanking affiliates and the investment companies associated with them, must be viewed as a single entity." The Board has applied the "single entity" theory when it would further Congressional intent (for example, see 12 CFR 218.107). However, to apply the "single entity" theory in the manner suggested would, it seems, require the Board to ignore totally the structure fashioned by Congress to divorce commercial banking from investment banking when it enacted the Glass-Steagall Act. The Glass-Steagall Act contained four key sections to carry out this purpose; three (sections 20, 21 and 32, 12 U.S.C. 377, 378 and 78, respectively)

were initially new sections and the fourth (section 16) contained an amendment to Paragraph Seventh of section 5136, Revised Statutes, 12 U.S.C. 24. Briefly stated, section 21 prohibits any bank from engaging in the securities business directly, section 20 prohibits an affiliation of a member bank with an organization "engaged principally" in the securities business and section 32 prohibits interlocking relationships between member banks and companies "primarily engaged" in the securities business. As the U.S. Supreme Court observed in *Board of Governors* v. *Agnew*, 329 U.S. 441, at page 448:

> "On the other hand, when Congress came to deal with the practice of underwriters taking checking desposits, it used language different from what it used in either §§ 19 and 20 on the one hand or in § 32 on the other. By § 21 it prohibited any organization 'engaged' in the underwriting business 'to engage at the same time to any extent whatever' in the business of receiving checking deposits. Thus within the same Act we find Congress dealing with several types of underwriting firms—those 'engaged' in underwriting, those 'primarily engaged' in underwriting, those 'engaged principally' in underwriting. The inference seems reasonable to us that Congress by the words it chose marked a distinction which we should not obliterate. . ."

Furthermore, section 21 is a criminal statute and, as such, must be strictly construed. In addition, the single entity theory would require the Board to ignore the intent of Congress when it enacted the 1970

Amendments to the Bank Holding Company Act; clearly, Congres intended the Board to authorize bank holding companies to engage in activities that could not be conducted by banks directly. H.R. Rep. No. 91-1747, 91st Cong., 2nd Sess. (1970). Accordingly, the Board is of the opinion that the prohibitions of section 21 apply only to a bank and may not be held applicable to a bank holding company or a nonbank subsidiary of a bank holding company.

Furthermore, even if section 21 were held to apply to a bank holding company or a nonbank subsidiary of a bank holding company, the Board does not believe that section 21 would be violated by any action taken in accordance with the regulatory provision in question. Concurrently with the adoption of the amendment to Regulation Y to permit bank holding companies to act as investment advisers to investment companies, the Board issued an interpretation explaining the scope of such activity (12 CFR 225.125). In that interpretation, the Board clearly stated that "a bank holding company should not engage, directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." Illustrations of prohibited sales practices were also provided in that interpretation. A review of the Exhibits accompanying the petition filed with the Board indicates that, except for the special purpose Georgia investment companies, commented on below, wherever a bank or bank holding company has acted as an investment adviser to an investment company, an independent

underwriting firm was used to distribute the fund's securities. It is suggested in the petition (page 29) that "it strains credulity to believe that such restrictions can succeed in preventing active promotion by bank holding companies and their affiliates of funds which they have created and which they sponsor and control." No evidence has been submitted, however, to demonstrate that bank holding companies or their bank or nonbank subsidiaries have engaged in sales activities with respect to the shares of such funds. In the absence of such evidence and in view of the criminal penalties for violations of the Bank Holding Company Act and the Board's regulations, it must be presumed that bank holding companies are acting lawfully.

In considering the permissibility of investment advisory activity for bank holding companies, the Board was especially careful to limit the scope of the permitted activity to investment advisory services, which has been a traditional banking function as long as there have been banks. As of December 31, 1972, over $403 billion in trust assets, including $277 billion in common stocks, were administered by banks. Although some of the same dangers cited by the United States Supreme Court in *ICI* v. *Camp*, 401 U.S. 617 (1971), may also be present with respect to the conduct of investment advisory activities, surely the Congress did not intend to prohibit banks from performing investment advisory services when it enacted the Glass-Steagall Act. Moreover, in the Board's opinion, there are several significant distinctions be-

tween the investment fund before the Court in *Camp* and the activity authorized by the Board. In the *Camp* case, interests in the investment fund were offered and sold by the bank; here bank holding companies are prohibited from that activity. Further, in the *Camp* case, it might be argued that there were promotional pressures to sell additional interests in the fund in order to prevent contraction of the fund and to increase the bank's advisory fee which was based on total assets held by the fund. However, in the case of a closed-end fund, there are no such promotional pressures on the adviser because the fund's growth results principally from increase in asset value, rather than from external growth. Therefore, the adviser's economic incentive to increase its compensation is accomplished by furnishing superior investment advice, rather than engaging in sales activities.

Further, the adoption of a dividend reinvestment plan by a closed-end fund does not, in the Board's opinion, change its character to that of an open-end fund. Securities issuances by companies pursuant to such plans are generally *de minimis* in relation to the size of the company's capital structure and, in any case, the Board does not believe the dangers that the Glass-Steagall Act was enacted to prevent are present to any significant degree with respect to such plans. Accordingly, the Board does not believe that the operations of such plans are within the prohibitions of the Glass-Steagall Act.

The four funds referred to in the petition described as "open end" investment companies require special mention. As the petition points out, investment in three of these funds, Invesco Equity Fund, Inc., Invesco Income Fund, Inc., and Temporary Investment Fund, Inc., is limited to banks and other institutions and not to general members of the public. Invesco Equity Fund and Invesco Income Fund are each a "fiduciary investment company" within the meaning of and pursuant to the Georgia Fiduciary Investment Company Act. Although technically open-end funds, the Board believes that their operation is not within the legislative purpose to which the Glass-Steagall Act was directed and it would be contrary to the public interest to invoke its sanctions to their operation. Unlike the two Invesco Funds, Temporary Investment Fund is not operated pursuant to special purpose legislation. However, Loeb, Rhoades & Co., an independent investment banking firm, is identified as the "sponsor" and "administrator-distributor" of the Fund. As far as can be determined, the Fund's investment adviser, Provident National Bank, acts only as the Fund's investment adviser and as transfer agent, dividend disbursing agent and custodian of its assets, all of which are within the scope of the Board's permitted activities (12 CFR 225.125). (In any case, as discussed further hereinafter, the Board's regulation and accompanying interpretation does not apply to investment advisory services by "banks".) Lastly, although Peachtree Equity Securities, Inc. is technically an open-end investment company, since

its shares are redeemable at net asset value at any time, the prospectus relating to its initial public offering states "After completion of this offering, Peachtree will not continuously or frequently offer its shares." To the Board's knowledge, this representation has been complied with. Accordingly, the Board believes that for Glass-Steagall Act purposes, Peachtree Equity Securities, Inc. should be considered a closed-end fund.

The second argument in the petition is that, where the activities authorized by Regulation Y are undertaken by national banks or by State banks that are members of the Federal Reserve System, they violate section 16 of the Glass-Steagall Act. That provision states, in pertinent part, as follows: "The business of dealing in securities and stock by the [national banking] association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers and in no case for its own account, and the association shall not underwrite any issue of securities or stock . . ." (12 U.S. 24(7)). Section 335 of Title 12 of the U.S. Code applies this restriction to State member banks. The Board understands your argument to be that because of these provisions, a national or State member bank may not place an order with independent broker-dealer firms for the sale or purchase of stocks or other securities for the investment portfolios of funds for which they render investment advice and that because the Board's regulation permits such activity, it is invalid.

First, it is important to note that the Board's regulation was adopted pursuant to section 4(c)(8) of the Bank Holding Company Act and authorizes investment advisory activity to be conducted by a nonbanking subsidiary of the holding company. The authority of national banks or State member banks to furnish investment advisory services does not derive from the Board's regulation; such authority would exist independently of the Board's regulation and its scope is to be determined by a particular bank's primary supervisory agency. The Board's interpretation of the scope of the investment advisory activity to be permitted (12 CFR 225.125) does define bank holding company to include "both their bank and nonbank subsidiaries." However, the restrictions contained in the interpretation on operations of banking subsidiaries were only intended to apply where the investment advisory function was being conducted by a nonbanking subsidiary of the bank holding company. Accordingly, even *assuming arguendo* that national or State member banks that act as investment advisers to investment companies would violate section 5136 in doing so, this would not be a reason for invalidation of the Board's regulation; such banks are not acting pursuant to the Board's regulation when they perform such activity.

The Board has, however, addressed itself to the substantive question presented since it is the primary Federal bank supervisory agency for State member banks of the Federal Reserve System, although it does not presume to speak for the Comptroller of the

Currency who is the primary bank regulator for national banks. As noted above, banks historically have furnished investment advice to trust accounts; these include testimentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities. The petition suggests that this service may not be performed for closed-end investment companies advised by member banks since these funds are "created" by the bank and, therefore, are not "customers" of the bank. If this reasoning were to be adopted, every trust that was suggested or which was reviewed by a bank officer prior to execution of a trust instrument might be said to be a creation of the bank and, therefore, not a customer. Obviously, the Board cannot adopt a strained construction of a statute that would lead to an unreasonable result. *U.S.* v. *American Trucking Association*, 310 U.S. 534 (1940). Further, there is no reason to believe that Congress intended to impute a narrow meaning to the term "customer" when it enacted section 16 of the Glass-Steagall Act. The purpose of this provision was to restrict the power of banks to deal in securities for their own account but leave unimpaired the previously recognized authority of banks to buy or sell securities for the account of customers. S. Rep. No. 77, 73rd Cong., 1st Sess. 16 (1933). In brief, in the Board's opinion, orders placed by a State member bank for the sale or pur-

chase of stock or securities for the account of an investment company advised by the bank or by a bank holding company affiliate constitutes a transaction for the account of a "customer" and is not prohibited by Paragraph Seventh of section 5136, as applied to State member banks by ¶ 20 of section 9 of the Federal Reserve Act.

The Board also considered and rejected the argument in the petition that certain indemnification provisions, whereby banks and bank holding company affiliates have indemnified the underwriter of a fund's securities against certain liabilities, including liabilities under the Securities Act of 1933, have rendered the bank or bank holding company affiliate an "underwriter" for Glass-Steagall purposes. The indemnification provisions in question are of the usual, routine type common to most securities underwritings whereby a party which has furnished information to be included in a prospectus agrees to be responsible for the accuracy of such information. To the Board's knowledge, neither the Securities and Exchange Commission nor any other administrative or judicial authority has determined that the existence of such an indemnification provision would make the indemnifying party an underwriter for purposes of the statutes administered by the Commission. In any case, in the Board's judgment, it would not further the purposes of the Glass-Steagall Act to adopt such an interpretation here.

In its consideration of the petition, the Board also considered your request that the Board conduct a

hearing upon notice to interested parties. Prior to adoption of the regulatory provision at issue, the Board granted a petition of your client, ICI, for a hearing and you, on behalf of your client, participated extensively in that hearing which was held on November 12, 1971. Some of the same arguments that are contained in the petition were made at that hearing and they were considered by the Board at the time of its adoption of section 225.4(a)(5)(ii). In the Board's judgment, there are no facts in dispute that need be resolved by a hearing nor does it appear that a hearing would serve any useful purpose. Further, an additional hearing at this time is not required by the Bank Holding Company Act or the Administrative Procedure Act. *BankAmerica Corporation* v. *Board of Governors*, F. 2d. (9th Cir., January 29, 1974); *Federal Power Commission* v. *Texaco, Inc.*, 377 U.S. 33 (1964). Accordingly, the Board has denied your request for a hearing.

Very truly yours,

/s/ Theodore E. Allison
THEODORE E. ALLISON
Assistant Secretary of
the Board

APPENDIX E

Petition of Investment Company Institute for Reconsideration and Recision of a Regulation of the Board, 12 C.F.R. § 225.4(a)(5)(ii)

ORDER

On January 29, 1972, the Board promulgated a regulation, 12 C.F.R. § 225.4(a)(5)(ii), and interpretive ruling, 12 C.F.R. § 225.125, by which it determined that the activity of serving as an investment advisor, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act is closely related to banking and thus a permissible activity for bank holding companies to engage in, subject to the procedures set out in the Board's Regulation Y, 12 C.F.R. § 225. 37 *Federal Register* 1463-1464 (1972). Notice of the rulemaking had been duly given in the *Federal Register* on August 25, 1971, 36 *Federal Register* 16695, and on September 1, 1971, 36 *Federal Register* 17514; and a public hearing on the matter was held on November 12, 1971.

On December 12, 1973, the Investment Company Institute ("ICI"), Washington, D.C., the national association for the American mutual fund industry, filed with the Board a petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii). The Board duly considered ICI's petition and, by letter dated March 8, 1974, the Board denied the petition and responded in detail to the arguments that ICI

had raised. ICI thereafter sought judicial review of the Board's order denying its petition for reconsideration. However, the United States District Court for the District of Columbia dismissed ICI's petition for review in an order dated July 30, 1975, 398 F. Supp. 725; and the Court of Appeals subsequently affirmed the District Court's order of dismissal for lack of subject matter jurisdiction, 551 F.2d 1270 (D.C. Cir. 1977). Nevertheless, the Court of Appeals, having determined that the state of the law of jurisdiction was not clear at the time ICI filed its previous petition, determined that ICI should have the opportunity to file a second petition for reconsideration and recision of the Board's regulation.

Pursuant to the Court's order ICI has filed a second petition for reconsideration and recision with the Board. The petition is accompanied by a memorandum containing ICI's legal arguments and by affidavits setting out facts in support of the petition. In addition, ICI has requested that the Board convene a formal hearing pursuant to the Administrative Procedure Act and that ICI's most recent petition be determined on the record of such a hearing. ICI has not protested or filed comments with respect to any application by a bank holding company for permission to engage in the activity described in 12 C.F.R. § 225.4(a)(5)(ii).

The additional facts presented by ICI with the present petition are to the same effect as the facts presented with ICI's previous petition for reconsideration: a number of banking organizations are giving

investment advice to investment companies registered under the Investment Company Act of 1940. However, as with ICI's previous petition to the Board, most of the investment advisors identified by ICI are commercial banks, as distinguished from bank holding companies, which did not seek the Board's prior approval pursuant to 12 U.S.C. § 1843(c)(8) and 12 C.F.R. § 225 before commencing the subject investment advisory activities.[1] The Board's regulation governs the investment advisory activities of bank holding companies and their nonbanking subsidiaries. The conduct of commercial banks in this area is subject to administrative sanction at the Federal level by the Comptroller of the Currency (as to national banks) and the Board (as to state member banks); but such supervision is exercised without regard to the Bank Holding Company Act or the challenged regulation. ICI and courts before which ICI has argued have recognized these distinctions in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) and in *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977). Although the national banking organizations in those cases, whose activities were alleged to be in violation of the Glass-Steagall Act, were holding company subsidiaries, it

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[1] All seven of the open-end funds identified on page 12, footnote 6 of ICI's Memorandum are advised by banks; and the Board has no record of the filing of any application under the Bank Holding Company Act relating to these activities. In addition, 8 of 12 funds identified on page 7, footnote 2 of ICI's Memorandum are advised by banks or subsidiaries of banks.

is clear that the courts as well as ICI viewed the Comptroller as the appropriate regulatory authority to consider the Glass-Steagall Act questions. Nevertheless, ICI asks the Board to rescind its regulation although the activity being complained of is being conducted chiefly by banks and the Board was not asked to approve, and in fact did not approve the activity pursuant to Regulation Y.[2]

ICI's most recent petition also suggests that the Board consider the circumstances surrounding the

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[2] ICI claims that the Board's previously expressed position that the challenged regulation and interpretation do not cover the activities of commercial banks "involves, as a practical matter, an illusory distinction." However, as the United States Court of Appeals in the District of Columbia Circuit stated with respect to the Board's determination that a certain other activity is closely related to banking, "[t]he order under review does not itself authorize any particular bank holding company to engage in courier activities." *National Courier Association* v. *Board of Governors*, 516 F.2d 1229, 1233 n.4 (D.C. Cir. 1975). To give investment advice *pursuant to the challenged regulation*, a company must file an application pursuant to 12 C.F.R. § 225. That the commercial bank advisors identified by ICI have failed to do so merely evidences the fact that their activities are not subject to the regulation and are not being engaged in pursuant thereto. The fact that some of the investment funds thus advised cite the Board's interpretation in their securities registration statements may indicate an acceptance of the Board's distinction between open-end and closed-end companies for purposes of determining whether affiliated investment companies "engaged principally" or "primarily engaged" in the securities business and thus whether sections 20 and 32 of the Glass-Steagall Act were violated. The logic of ICI's position would require approval under the Bank Holding Company Act of almost all corporate activities carried out by banks directly. This Congress clearly did not intend.

formation of certain open-end funds which purport to be sponsored by brokerage organizations and to receive only investment advice from various bank affiliates of bank holding companies; the circumstances surrounding the organization and subsequent open-end conversion of Advance Investors Corporation; the feasibility as a commercial matter that investment funds can and will select banks as advisor without bank participation in the creation of the fund; and the desirability of regulating and prohibiting certain relationships between bank holding company affiliates and firms which sponsor or administer funds, such as the placement of brokerage, extensions of credit, and business referrals.

In presenting the above suggestion of topics to be considered by the Board, ICI does not raise issues of material fact that are appropriate for resolution by the Board in this proceeding. ICI notes that at least seven open-end investment companies created since ICI's previous petition are advised by commercial banks and that such banks have undertaken to restrict their activities with respect to such funds to the giving of investment advice. But ICI, which suggests the banks may have illegally sponsored these funds and indicates the banks place brokerage with the nominal sponsors, does not indicate that these activities are being engaged in pursuant to the Board regulation here challenged by ICI. All seven investment advisors named are banks, and no applications for prior approval of these activities were filed with or considered by the Board under § 4(c)(8) of the

Bank Holding Company Act and the related regulations.[3]

ICI also reiterates its previous position that bank holding companies should not be permitted to sponsor closed-end funds. However, in support of its contention ICI indicates that a certain closed-end fund recently converted itself into an open-end fund. ICI argues that if the bank sponsor intended to open-end the fund from the day the fund was created, sections 16 and 21 would have been violated; but ICI admits "we presently have no reason to suspect that the foregoing is what actully happened."

As set forth more fully below, the Board has determined that a formal hearing is not required or approriate in the present case. Neither the Administrative Procedure Act, 5 U.S.C. § 551, *et seq.*, nor the Bank Holding Company Act, 12 U.S.C. § 1841 *et seq.*, requires that the Board's rulemaking proceedings be governed by formal procedures such as those used in judicial trials and administrative adjudications. In fact the latter statute has been amended by Congress to provide that the Board's proceedings need not be held "on the record"; and this amendment has the effect of preserving the Board's ability to use informal rulemaking procedures. See, *e.g.*, *Independent*

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[3] Although some of the named banks are state member banks, the Board has not been asked by ICI to determine whether such banks are violating the Glass-Steagall Act through the named activities, but only whether their activities can be viewed as closely related to banking under a statute, section 4(c)(8) of the Bank Holding Company Act, on which they have not relied in commencing these activities.

Bankers Association of Georgia v. *Board of Governors*, 516 F.2d 1206 (D.C. Cir. 1975).

The Board has also determined that informal hearing procedures, like those used by the Board when it considered adoption of the challenged regulation in 1971, are not required for full and fair disposition of ICI's most recent petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii). ICI fully participated in the hearing held in this matter prior to adoption of the regulation. The question raised by ICI—whether the challenged regulation and interpretive ruling allow bank holding companies to violate sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. §§ 24 and 378—is a legal question and was considered in the Board's deliberations leading to adoption of the regulation and in response to ICI's previous petition for reconsideration. Finally, ICI has presented no new facts which raise issues of material fact for resolution by the Board; and as discussed hereinafter the Board has concluded that the factual inquiries suggested by ICI are best left for later adjudicatory proceedings which may, depending on the circumstances, require use of formal or informal hearing procedures. Such adjudicatory proceedings must be held before any bank holding company may engage in the activity described by 12 C.F.R. § 225.4 (a)(5)(ii). See generally 12 C.F.R. § 225.4.

In support of its request for a hearing, ICI cites several judicial decisions in which courts of appeals have determined that hearings were appropriate on applications by bank holding companies for permis-

sion to engage in activities previously determined by the Board to be closely related to banking. *Alabama Association of Insurance Agents* v. *Board of Governors*, 533 F.2d 224 (5th Cir., 1976); *Independent Bankers Association of Georgia* v. *Board of Governors*, 516 F.2d 1206 (D.C. Cir. 1975). ICI argues that it would be entitled to a hearing were it opposing such an application, and that it should have a hearing in this case because the Court of Appeals recognized that ICI's interest in the Board's regulation extends beyond the facts of any particular application. However, these cases and ICI's argument appear to support the Board's conclusion that ICI's proposed factual inquiries should be resolved in later adjudicatory proceedings.

ICI apparently recognizes that the Board must determine two questions with respect to section 4(c)(8) and that the second question, the "public benefits" question, is the one that creates the need for a factual inquiry. Memorandum in Support of Petition for Reconsideration, pp. 32-33. In discussing its proposed factual inquiries, ICI states:

> "We submit, therefore, that Section 225.4(a)(5)(ii) requires reconsideration not only to prevent the direct sponsorship of closed-end funds in violation of the Glass-Steagall Act, as we have previously contended, but also to avoid another problem: that is, situations involving open-end funds which may not on their face demonstrate Glass-Stegall violations, but which *depending on the facts*, may indeed involve violations. In any event, these situations also pre-

> sent the possibility of a clear conflict with the Board's responsibilities under the Bank Holding Company Act to avoid 'undue concentration of resources, decreased or unfair competition [or] conflicts of interest. . . .' 12 U.S.C. § 1843(c)(8)." [Emphasis supplied]

Memorandum, pp. 20-21. It is thus clear that ICI is asking the Board to apply the "public benefits" test of section 4(c)(8) in the context of an industry-wide rulemaking. ICI's allegations, however, go to the facts of particular operations by individual companies and how they bear on the public benefits aspects. See *National Courier Association* v. *Board of Governors*, 516 F.2d at 1233. Moreover, it is not clear whether the banking organizations identified in ICI's most recent petition would intervene in any hearing convened by the Board at this time, since most such organizations are not engaging in investment advisory activities pursuant to 12 C.F.R. § 225.4(a)(5)(ii); and it is not apparent how the factual inquiries proposed by ICI can be pursued absent such intervention. None of these organizations intervened in the lawsuit that preceded ICI's filing of the present petition. The present petition for reconsideration of a rule does not involve "resolution of conflicting private claims to a valuable privilege." *Action for Children's Television* v. *United States*, No. 74-2006 (D.C. Cir., decided July 1, 1977). For the

foregoing reasons, the request for a hearing should be, and it hereby is, denied.[4]

The next question presented for the Board's consideration is whether the Board should reconsider and rescind 12 C.F.R. § 225.4(a)(5)(ii). ICI argues that the challenged regulation and interpretation authorize bank holding companies to violate sections 16 and 21 of the Glass-Steagall Act. Among other things, ICI claims that bank holding companies and their banking subsidiaries are single entities, and that sections 16 and 21 are violated by the activities of such companies engaged in pursuant to the Board's regulations.

In its previous orders in this matter—37 *Federal Register* 1463-1464; letter of March 8, 1974, from the Board's Secretary to ICI's counsel—the Board dealt with ICI's contentions on the merits in considerable detail. After due consideration of the present

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[4] ICI indicates it is aware of the Board's weekly press release (Form H-2) and *Federal Register* notice summarizing each action taken and application received by the Board during the week covered by these notices. See above Memorandum in Support of Petition for Reconsideration, p. 10. ICI may challenge any future application to the Board for permission to advise open-end or closed-end funds by responding to such notices or to the *Federal Register* or publication notices given on each such application to the Board. If any activity previously authorized by the Board has led to Glass-Steagall Act violations in spite of the safeguards and restrictions in 12 C.F.R. § 225.125, ICI may petition the Board to institute cease and desist proceedings pursuant to 12 U.S.C. § 1818, or may refer alleged criminal violations of the Act directly to the appropriate United States Attorney, or may simply itself sue the offending banking organization. *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977).

petition and of those previous orders, and of the entire record that has been made in this proceeding, the Board believes its previous orders were legally and factually correct. Accordingly, the Board hereby reaffirms its previous orders in this matter and incorporates both orders by reference herein.

In what appears to the ICI's principal attempt to present "any relevant information which is developed in the interim" (since the Board's consideration of ICI's first petition for reconsideration), as suggested by the Court of Appeals, ICI alludes to information which suggests banks acting as investment advisors regularly place brokerage transactions with the brokerage houses which have been designated as the sponsors of the funds that they advise (Memorandum, pages 19-22). ICI then proceeds to argue that this may involve "undue concentration of resources, decreased or unfair competition [or] conflicts of interest . . ." which are factors that the Board must consider under section 4(c)(8). ICI thereupon states "If the Board were to prohibit or restrict the placement of brokerage by a bank holding company subsidiary with a firm which sponsors a mutual fund for which the subsidiary acts as investment advisor and otherwise regulate or prohibit transactions between the two entities, it would be possible to be far more confident that the selection and retention of banks as investment advisors to funds they allegedly do not 'sponsor' will be based upon proper competitive considerations."

In the Board's view ICI's argument in this regard is without merit. In the passage just cited, it would appear that ICI is admitting that the new open-end funds are sponsored and controlled by the brokerage firms, rather than the bank advisors.[5] Furthermore, the obligations of a fund's directors with respect to selection of its investment advisor are clearly spelled out in the Investment Company Act of 1940 and Congress recently considered at length and enacted legislation dealing with the question of selection of brokerage firms by money managers as part of the Securities Acts Amendments of 1975 (15 U.S.C. 28(e)(1)); Sen. Rep. 94-75, pp. 69-71). Accordingly, the Board believes that this subject matter is fully covered by existing law and that it would serve no useful purpose to consider the matter at this time in discharging its responsibilities under the Bank Holding Company Act.

The Board has placed conditions upon the investment advisory activities of bank holding companies and their nonbanking subsidiaries designed to prevent the occurrence of Glass-Steagall Act violations as a result of such activities. 12 C.F.R. § 225.125. For example, bank holding companies may advise

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[5] In addition, on page 20 of its Memorandum, ICI also states "Thus, while the ranks of directors and officers of the new open-end funds may be dominated by personnel asosciated with the brokerage house and not with the bank, some doubt arises as to the practical likelihood that the decision to retain the bank as investment advisor to the fund will in all instances be made objectively on the basis of capabilities and performance, without consideration of the substantial benefits which the bank is in a position to confer upon the brokerage house."

but may not sponsor open-end investment companies because such companies may be said to be "engaged principally" or "primarily engaged" in the securities business through the issuance of securities on a more or less regular basis. Moreover, bank holding companies may affiliate with closed-end investment companies only "as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. This is consistent with —and even stricter than—the provision of section 20 of the Glass-Steagall Act which merely prohibits affiliations with a member bank where a company is "engaged principally" in securities activities.

In addition, the Board stated in its interpretive ruling that the provisions of the Glass-Steagall Act are not affected by the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760), and that the Board's regulation and the interpretative ruling are consistent "with the spirit and purpose of the Glass-Steagall Act. . . ."

> It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment advisor. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of

> whether they have subsidiaries that are member banks.

12 C.F.R. 225.125(b). The Board also stated that bank holding companies may not undertake any activity prohibited by the Glass-Steagall Act:

> The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an "investment advisor" under the Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

12 C.F.R. 225.125(d). Pursuant to 12 U.S.C. § 1818, the Board may issue cease and desist orders to restrain violations of law by bank holding companies, including violations of the Glass-Steagall Act. The Board is prepared to use this authority where it appears that a bank holding company has violated or is violating 12 C.F.R. § 225.4(a)(5)(ii) or any of the limitations on investment advisory activities specified in 12 C.F.R. § 225.125. If ICI is aware of any such violations of law which merit investigation by the Board or the institution of cease and desist proceedings pursuant to 12 U.S.C. § 1818, it should advise the Board accordingly. In addition, ICI may seek intervention in any future proceeding arising out of an application by a bank holding company for permission to give investment advice pursuant to 12 C.F.R. § 225.4(a)(5)(ii), if it believes the applicant bank holding company may violate the Glass-Steagall Act. ICI thus has the same remedies available to it in this case as it has with respect to the bank invest-

ment service activities that it challenged in *New York Stock Exchange and Investment Company Institute* v. *Robert Bloom*, No. 76-1235 (D.C. Cir., decided July 19, 1977), as well as the additional remedy of being able to seek intervention in future adjudicatory proceedings under the challenged regulation.

For the foregoing reasons, ICI's petition for reconsideration and recision of 12 C.F.R. § 225.4(a)(5)(ii) should be, and it hereby is, denied.

By order of the Board of Governors,[6] effective August 31, 1977.

(Signed) Theodore E. Allison
THEODORE E. ALLISON
Secretary of the Board

[SEAL]

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[6] Voting for this action: Vice Chairman Gardner, and Governors Wallich, Jackson, Partee and Lilly. Absent and not voting: Chairman Burns and Governor Coldwell.

APPENDIX F

Federal Register notice of January 29, 1972 publishing the amendment to Section 225.4(a) of Regulation Y and the interpretive ruling accompanying said amendment

TITLE 12—BANKS AND BANKING

CHAPTER II—FEDERAL RESERVE SYSTEM

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Y]

PART 225—BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

By notice of proposed rulemaking published in Federal Register on August 25, 1971 (36 F.R. 16695), the Board of Governors proposed to add to the list of activities that it has determined to be closely related to banking or managing or controlling banks (§ 225.4(a) of Regulation Y) the following: "serving as investment adviser to an investment company registered under the Investment Company Act of 1940". A hearing on this proposal was held on November 12, 1971, after a notice thereof was published in the Federal Register on October 29, 1971 (36 F.R. 20779).

Following consideration of the comments received and the record of the hearing, the Board has amended § 225.4(a), effective February 1, 1972, to add the

new activity, with a minor modification in language from that proposed, to its list of permitted activities.

An accompanying interpretation expresses the Board's views on several questions, which arose during the course of its consideration of this matter, concerning the scope of the new activity and the applicability of certain provisions of the Banking Act of 1933 (48 Stat. 162) thereto.

The text of the amendment to § 225.4(a) reads as follows:

§ 225.4 NONBANKING ACTIVITIES.

(a) *Activities closely related to banking or managing or controlling banks.* * * * The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

* * *

(5) acting as investment or financial adviser, including (i) serving as the advisory company for a mortgage or a real estate investment trust; (ii) serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act; and (iii) furnishing economic or financial information; **

** For an interpretation relating to the scope of the activity described in (ii) see 12 C.F.R. 225.125. Acting as a management consultant is not regarded by the Board as within this activity (5). Whether to propose expanding activity (5) to include management consulting is under consideration by the Board.

Effective date: February 1, 1972.

By order of the Board of Governors, January 20, 1972.

(Signed) Tynan Smith
TYNAN SMITH
Secretary of the Board

[SEAL]

TITLE 12—BANKS AND BANKING

CHAPTER II—FEDERAL RESERVE SYSTEM

SUBCHAPTER A—BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

[Reg. Y]

PART 225—BANK HOLDING COMPANIES

Nonbanking Activities of Bank Holding Companies

§ 225.125 INVESTMENT ADVISER ACTIVITIES.

(a) Effective February 1, 1972, the Board of Governors amended § 225.4(a) of Regulation Y to add "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act" to the list of activities it has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. During the course of the Board's consideration of this amendment several questions arose as to the scope of such activity, particularly in view of certain restrictions imposed by sections 16, 20, 21 and 32 of the Banking Act of 1933 (12 U.S.C. 24, 377, 378, 78) (sometimes referred as the "Glass-Steagall Act provisions") and the United States Supreme Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). The Board's views with respect to some of these questions are set forth below.

(b) It is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 (84 Stat. 1760) that the Glass-Steagall Act provisions were not intended to be affected thereby. Accordingly, the Board regards the Glass-Steagall Act provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment adviser. Consistently with the spirit and purpose of the Glass-Steagall Act, this interpretation applies to all bank holding companies registered under the Bank Holding Company Act irrespective of whether they have subsidiaries that are member banks.

(c) Under § 225.4(a)(4), as amended, bank holding companies (which term, as used herein, includes both their bank and nonbank subsidiaries) may, in accordance with the provisions of § 225.4(b), act as investment advisers to various types of investment companies, such as "open-end" investment companies (commonly referred to as "mutual funds") and "closed-end" investment companies. Briefly, a mutual fund is an investment company which, typically, is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer; a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares.

(d) The Board intends that a bank holding company may exercise all functions that are permitted to be exercised by an "investment adviser" under the

Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter.

(e) The Board recognizes that presently most mutual funds are organized, sponsored and managed by investment advisers with which they are affiliated and that their securities are distributed to the public by such affiliated investment advisers, or subsidiaries or affiliates thereof. However, the Board believes that (i) the Glass-Steagall Act provisions do not permit a bank holding company to perform all such functions, and (ii) it is not necessary for a bank holding company to perform all such functions in order to engage effectively in the described activity.

(f) In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund. However, the Board does not believe that such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities. In no case, however, should a bank holding company act as investment adviser to an investment company which has a name that is similar to, or a variation of, the name of the holding company or any of its subsidiary banks.

(g) In view of the potential conflicts of interests that may exist, a bank holding company and its bank and nonbank subsidiaries should not (i) purchase for their own account securities of any investment company for which the bank holding company acts as

investment adviser; (ii) purchase in their sole discretion, any such securities in a fiduciary capacity (including as managing agent); (iii) extend credit to any such investment company; or (iv) accept the securities of any such investment company as collateral for a loan which is for the purpose of purchasing securities of the investment company.

(h) A bank holding company should not engage, directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser. Prospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regarding any investment company for which the bank holding company acts as investment adviser may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor. Further, a bank holding company should not act as investment adviser to a mutual fund which has offices in any building which is likely to be iden-

tified in the public mind's with the bank holding company.

(i) Acting in such capacities as registrar, transfer agent, or custodian for an investment company is not a selling activity and is permitted under § 225.4(a)(4) of Regulation Y. However, in view of potential conflicts of interests, a bank holding company which acts both as custodian and investment adviser for an investment company should exercise care to maintain at a minimal level demand deposit accounts of the investment company which are placed with a bank affiliate and should not invest cash funds of the investment company in time deposit accounts (including certificates of deposit) of any bank affiliate.

(Interprets and applies 12 U.S.C. 1843(c)(8).)

By order of the Board of Governors, January 20, 1972.

(Signed) Tynan Smith
TYNAN SMITH
Secretary of the Board

[SEAL]

APPENDIX G

RELEVANT STATUTORY PROVISIONS

1. 12 U.S.C. 24 Seventh provides in pertinent part:

> * * * The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

2. 12 U.S.C. 221a(b) provides:

> Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization—
>
> > (1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or
> >
> > (2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares

voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or

(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank; or

(4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

3. 12 U.S.C. 377 provides in pertinent part:

After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: * * *.

4. 12 U.S.C. 378 provides in pertinent part:

After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor: * * *.

5. 12 U.S.C. 1843(a) provides in pertinent part:

Except as otherwise provided in this Act, no bank holding company shall—

(1) after the date of enactment of this Act acquire direct or indirect ownership or control of any voting shares of any company which is not a bank, * * *.

6. 12 U.S.C. 1843(c) provides in pertinent part:

The prohibitions in this section shall not apply to

* * * * *

(7) shares of an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company;

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

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Supreme Court, U. S.
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APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner

—*v.*—

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FILED: DECEMBER 13, 1979
PETITION GRANTED: FEBRUARY 19, 1980

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner

—*v.*—

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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* The opinion, related orders, and judgment of the court of appeals, the orders of the Board of Governors of the Federal Reserve System, and the challenged regulation and interpretive ruling of the Board are reproduced as appendices to the petition for certiorari and are not printed here.

IN THE MATTER OF THE AMENDMENT OF REGULATION Y OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TO PROVIDE THAT SERVING AS INVESTMENT ADVISER TO A REGISTERED INVESTMENT COMPANY IS CLOSELY RELATED TO BANKING.
(12 C.F.R. § 225.4(a)(5)(ii))

BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

RELEVANT DOCKET ENTRIES

DATE	DESCRIPTION
Aug. 17, 1971	Notice of proposed rulemaking
Sept. 23, 1971	Investment Company Institute's ("ICI") comments and request for hearing on proposed rule
Oct. 21, 1971	ICI's supplemental comments on proposal
Nov. 12, 1971	Hearing on proposed rule
Nov. 26, 1971	ICI's posthearing memorandum
Jan. 24, 1972	Notice of adoption of final rule and interpretation
Dec. 12, 1973	ICI's petition for reconsideration and rescission of the rule
March 8, 1974	Board's letter denying ICI's petition
March 18, 1977	ICI's second petition for reconsideration and rescission of the rule
Aug. 31, 1977	Board's order denying ICI's petition

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
(O) 9-23-77	4-Petitioner's petition for review of an order of the Board of Governors of the Federal Reserve System
(T) 11-8-77	Certified Index to Record (n-3)
(T) 12-29-77	15-Petitioner's brief (m-29)
(T) 12-29-77	10-Joint Appendix (m-29)
(T) 6-30-78	15-Respondent's brief (m-30)
(T) 7-28-78	15-Petitioner's reply brief (m-28)
(T) 10-18-78	Argued before McGowan and Wilkey, CJs; and Gasch, Oliver J., US District Court Judge for the District of Columbia
(J) 3-30-79	Opinion for the Court filed by Circuit Judge McGowan.
(J) 3-30-79	Judgment by this Court that the Board's regulation and interpretative ruling challenged in this case are hereby vacated, in accordance with the opinion of this Court filed herein this date.
(D) 5-11-79	4-Motion of BankAmerica Corporation, et al. for leave to file brief as amicus curiae (p-11)
(D) 5-11-79	4-Motion of New York Clearing House Association for leave to file brief as amicus curiae (p-11)

DATE	FILINGS—PROCEEDINGS

(E)5-16-79 11-Respondent's petition for rehearing and suggestion for rehearing en banc (m-11)

(E)6-1-79 Per Curiam order, sua sponte, that within 14 days of this order, petitioner shall file a response to the petition for rehearing and/or suggestion for rehearing en banc filed by Board of Governors; McGowan & Wilkey, CJ's and Gasch, US District Court Judge

(T)6-29-79 4-Motion of Securities Industry Association for leave to participate as amicus curiae (m-29)

(T)6-29-79 4-Motion of A.G. Becker Incorporated for leave to participate as amicus curiae (m-29)

(T)6-29-79 11-Petitioner's response to petition for rehearing and suggestion for rehearing en banc (m-29)

(J)7-13-79 Per Curiam order amending opinion filed on 3-30-79.

(C)7-16-79 Per Curiam order, en banc, denying respondent's suggestion for rehearing en banc; CJ Wright; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb & Wilkey, CJs

(C)7-16-79 Per Curiam order denying motions of BankAmerica Corporation, et al. and New York Clearing House Assoc. for leave to file memoranda as amici curiae; McGowan & Wilkey, CJs and Gasch, Judge, US District Court for DC (CJ McGowan did not participate)

(C)7-16-79 Per Curiam order, en banc, denying motions of BankAmerica Corp., et al. and New York Clearing House Assoc. for leave to file memoranda as amici curiae; CJ Wright; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb & Wilkey, CJs

(C)7-16-79 Per Curiam order denying respondent's petition for rehearing; McGowan and Wilkey, CJs and Gasch, US District Court Judge for DC

(C)7-16-79 Per Curiam order denying motions filed by Securities Industry Assoc and AG Becker, Inc. for leave to participate as amicus curiae; McGowan and Wilkey, CJs and Gasch, US District Judge for DC

CHARTER NEW YORK CORPORATION

Gordon T. Wallis
President

One Wall Street
New York, N.Y. 10005

September 10, 1971

Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Sir:

In response to the Board of Governors release of August 17, 1971, and your invitation for comments of interested persons, Charter New York Corporation would like to go on record as favoring the proposal of the Federal Reserve Board to amend Regulation Y under the Bank Holding Company Act to include as a banking related activity "serving as an investment adviser to an investment company registered under the Investment Company Act of 1940".

We believe this activity is clearly "closely related to banking", being consistent with the traditional role of banks in advising fiduciary and agency customers in their investment needs.

As proposed, the amendment does not seek to define either the term investment adviser or the range of services which may be provided by a bank holding company acting as an investment adviser. In addition to the adviser's primary function of furnishing a continuous investment program to an investment company, it customarily undertakes to provide ancillary services. These services may include, among others, acting as sponsor of the fund, pricing agent in the determination of the fund's net asset value and other "housekeeping" and management functions and may require the adviser to assume certain expenses otherwise payable by the fund. In order for holding companies to actively compete with non-bank advisers in servicing investment companies and to adequately protect the interests of the funds' investors, it

would be highly desirable if the Federal Reserve Board defined the scope of incidental activities which bank holding companies can perform as an investment adviser to an investment company.

Therefore, we urge the Board of Governors to clarify their proposed regulatory authorization by stating which incidental activities, normally engaged in by investment advisers of investment companies, bank holding companies may perform.

Very truly yours

/s/ Gordon T. Wallis

FIRST NATIONAL BOSTON CORPORATION
100 Federal Street
Boston, Massachusetts 02110

Richard D. Hill
Chairman of the Board

September 20, 1971

Board of Governors
Federal Reserve System
Washington, D.C. 20551

Gentlemen:

On August 17, 1971 the Board of Governors announced a further proposal concerning activities regarded as closely related to banking under the 1970 Amendments to the Bank Holding Company Act. In its August 17 announcement, the Board proposed to include specifically, within the activity of acting as investment or financial advisor, "(ii) serving as investment advisor to an investment company registered under the Investment Company Act of 1940", in addition to the business of "(i) serving as the advisory company for a mortgage or a real estate investment trust", and "(iii) furnishing economic or financial information". In its announcement the Board invited comment prior to September 24, 1971.

We would like to record our own long standing view that the business of furnishing investment advice to an investment company is a traditional fiduciary service which trust departments or member banks could always appropriately offer their trust department customers.

If we are correct in our judgment that the furnishing of investment advice to investment companies is already a recognized fiduciary activity, the question raised by the language of the Board's August 17 proposal is whether a bank subsidiary of a holding company which proposes to engage in such activity either within the bank itself or in an operating subsidiary of the bank is to be governed by the procedures applicable to acquisitions or activities undertaken under Section 4(c)(8) of the Bank Holding Company Act or whether in such case the activity or

acquisition is one in which the bank subsidiary or the bank's operating subsidiary may engage on the basis of Section 4(c)5 of the Bank Holding Company Act. We have in mind specifically the language of Section 222.4 of Regulation Y which became effective July 1, 1971, and in particular the second sentence thereof ". . .A national bank or a subsidiary thereof may acquire or retain shares on the basis of Section 4(c)(5) in accordance with the rules and regulations of the Comptroller of the Currency."

We believe the Board should make it clear that nothing in the language of the proposal is intended to restrict the traditional and acknowledged freedom of a bank (or bank operating subsidiary) to serve as investment adviser to any customer and that nothing here should impede free entry by a bank in this line of business. It would seem that a national bank or registered bank holding company may acquire an investment adviser under § 4(c)(8) and the procedures imposed by Regulation Y. Might it not be appropriate for the Board in its press release dealing with this activity to include an explanation to this effect?

We are also somewhat concerned by the implication that, in including specifically service as an investment advisor to an investment company registered under the Investment Company Act of 1940, the Board may be precluding a holding company affiliate from acting as an investment advisor to an investment company not registered under the Investment Company Act of 1940, such as an offshore fund.

We are, however, thoroughly in agreement with the Board that the activity of serving as an investment advisor to an investment company is pro-competitive and serves the public interest in that it encourages competition by banks and other bank related intermediaries in an area which has not so far significantly enjoyed the

benefit of the investment expertise of bank trust departments.

Sincerely

/s/ Richard D. Hill
RICHARD D. HILL
Chairman

Copy to:

Mr. Lee J. Aubrey, Vice President
Federal Reserve Bank of Boston

BEFORE THE
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

IN THE MATTER OF

PROPOSED AMENDMENT OF SECTION 222.4(a)(5) OF REGULATION Y: SERVING AS INVESTMENT ADVISOR TO AN INVESTMENT COMPANY REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

RICHARD W. MCLAREN
Assistant Attorney General

BARRY GROSSMAN
DANIEL R. HUNTER
NEIL E. ROBERTS
Attorneys
Department of Justice
Washington, D.C. 20530

BEFORE THE
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

IN THE MATTER OF

PROPOSED AMENDMENT OF SECTION 222.4(a)(5) OF REGULATION Y: SERVING AS INVESTMENT ADVISOR TO AN INVESTMENT COMPANY REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

By order dated August 12, 1971, the Board of Governors of the Federal Reserve system proposed an amendment to Section 222.4(a)(5) of Regulation Y, Bank Holding Companies. This amendment would add a new subparagraph (ii) to subsection (a)(5), thereby including "serving as investment advisor to an investment company registered under the Investment Company Act of 1940" as one of the activities which "have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto" and so permissible for bank holding company subsidiaries under Section 4(c)(8) of the Bank Holding Company Act, as amended. The Board invited comments by interested parties no later than September 24, 1971.

As the executive agency of the United States charged with responsibility for enforcing the antitrust laws and promoting competition, the Department of Justice is interested in questions raised by the expansion of bank holding companies into financially related nonbanking activities, and hereby submits its comments on the proposed amendment.

DISCUSSION

Entry of bank holding companies into the business of advising investment companies either by *de novo* entry or by the acquisition of small advisory firms might pro-

mote more vigorous competition in the investment advisory industry and thereby have a salutary effect on the public interest. While the business of advising investment companies (investment funds) does not appear to be highly concentrated, competition has not been effective in reducing advisory fees, primarily because of the absence of arm's length bargaining between the funds and their advisors.[1] The added competition which could be interjected into the fund advisory business by bank holding companies, particularly if it were accompanied by true arm's length bargaining between the advisor and the fund, might serve to reduce advisory fees in the industry. Such a result would certainly appear to serve the public interest and thus would be supported by the Department of Justice.

However, in view of the Supreme Court's recent decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), we find a serious question as to whether a bank holding company subsidiary may act as advisor to an open-end investment company (mutual fund). In that case, the Court held that Sections 16 and 21 of the Glass-Steagall Act (12 U.S.C. §§ 24, 378) prohibited a bank from "operating"[2] a mutual fund. In so holding, the Court outlined the following hazards which the Glass-Steagall Act was designed to prevent:

(1) The incentive to sell shares of a fund operated by the bank might distort the investment advice of the bank trust department (pp. 633, 636, 638);

(2) The bank might make unwise loans to customers for the purchase of fund shares (pp. 632, 638);

(3) The bank might make unsound loans to companies in which the fund had invested (pp. 631, 637);

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[1] See Statement of Commissioner Hugh F. Owens of the Securities and Exchange Commission, Hearings before the Senate Committee on Banking and Currency, 91st Cong., 1st Sess., on S.34 and S.296, to amend the Investment Company Act of 1940, (1969), pp. 28-29.

[2] It should be noted that the bank acted both as investment advisor and distributor of the fund shares and bank officers acted as directors of the fund. 401 U.S. at 622-23.

(4) The bank might make unsound loans to the fund itself (p. 638);

(5) Inadequate performance of a fund closely linked with a bank might impair public confidence in the bank (pp. 631, 637); and

(6) The bank might exploit confidential relationships with its commercial customers for the benefit of the fund (p. 638).

The *Investment Company* case was pending before the Supreme Court at the time that Congress enacted the 1970 amendments to the Bank Holding Company Act. There is no evidence in either the language of the 1970 Bank Holding Company Amendments or its legislative history which clearly indicates a Congressional intent to repeal or modify the prohibitions of the Glass-Steagall Act as applicable to bank holding company activity.

The *Investment Company* decision thus raises two related questions with respect to the proposed regulation: (1) whether as a matter of statutory construction of the Glass-Steagall Act bank holding company subsidiaries are prohibited from advising a fund, and (2) whether the hazards outlined in the decision apply to an investment advisor subsidiary of a bank holding company. Obviously, the more apparent the hazards, the more likely a Court will resolve difficult questions of statutory construction in favor of prohibiting the hazardous activity.

The statutory provision governing affiliations between member banks and securities firms is Section 20 of the Glass-Steagall Act (12 U.S.C. § 377) which provides that:

> ". . . no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities."

Section 221a(b)(2) defines an "affiliate" of a bank as an organization:

> "of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank."

Thus an investment advisory firm controlled by a bank holding company which controls a member bank is an "affiliate" of the member bank subsidiary of the holding company. Consequently, if the investment advisory subsidiary of a bank holding company (or any other affiliate) "distributed" the fund shares, as is the usual case with mutual fund managers, the bank holding company's member bank subsidiary would be in violation of Section 20, for its "affiliate" would be engaged in the prohibited act of "distribution."

We assume that the Board's proposed regulation is designed to limit a bank holding company's subsidiary to advising an investment company, as distinguished from distributing its stock. Thus the crucial issue is whether an affiliate strictly limited to *advising* a mutual fund "controls" the mutual fund within the meaning of Section 221a(b)(2). If it does, it might be said to control a company "principally" engaged in the "issue" of securities thereby placing its affiliated member bank in violation of Section 20 of the Glass-Steagall Act.[3]

It should be emphasized that an affiliate can be controlled within the meaning of § 221a, "through stock ownership *or in any other manner.*" (emphasis added) Obviously, forms of control other than stock ownership were contemplated by the framers of the Act. While "control" within the meaning of § 221a does not appear to have been defined, the Board has defined "control" in the context of its responsibilities under the Securities

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[3] The Board has determined that an open-end investment company (mutual fund) is "primarily" engaged in the issuing of securities within the meaning of § 32 of the Banking Act of 1933 (12 U.S.C. 78); 12 C.F.R. 218.101. Although in *Agnew* v. *Board of Governors*, 329 U.S. 441 (1947), the Court intimated that there might be a difference between "principally" and "primarily", the distinction is not readily apparent in the mutual fund context.

Exchange Act as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by *contract*, or otherwise" (emphasis added), (12 C.F.R. 206.1(f)). As amended in 1970, the Bank Holding Company Act provides that one company controls another if the first company "exercises a controlling influence over the management or policies" of the other company (12 U.S.C. 1841(a)(2)(c)). Finally, "control" within the meaning of the Investment Company Act means "the power to exercise a controlling influence over the management or policies of a company."[4] The ultimate issue would therefore seem to be whether a bank holding company acting as investment advisor to an open end investment fund exercises a controlling influence over the fund's management and policies. If it does, the relationship would appear to be prohibited by the Glass-Steagall Act.

An investment advisor of a mutual fund is defined as a person "who pursuant to contract with [the fund] regularly furnishes advice to [the fund] with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by [the fund]."[5] There are thus two general types of investment advisors: those who furnish advice on investments and those who have the power to determine themselves what investments the fund will make. Since the business of the fund is investing in securities, the person who has controlling influence over the investment decisions would seem to be "managing" the fund within the control test even though he does not manage the distribution of fund shares. If the fund directors delegate the power to determine investments to the advisor, the advisor would seem to be controlling the fund. A more difficult issue arises where the fund retains truly independent management which has the power to reject the recommendations of the advisor. This would be an

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[4] 15 U.S.C. 80a-2(a)(9).

[5] 15 U.S.C. 80a-2(a)(19).

unusual fund, since most funds are "externally managed", i.e., the advisor not only does investment research but makes the investment decisions. This avoids duplicating management. In the case of the bank holding company affiliate, however, it would seem that a functioning, internal management would be required in order to preclude "control." [6] Rather than merely rubber-stamping the recommendations of the investment advisor, the management would have to exercise true independent judgment. Whether such an arrangement is economically practical is certainly open to question. The existence of two "managements" might significantly raise costs to the fund.

Turning from the Glass-Steagall Act prohibitions to the policy underlying them, we find that some of the dangers outlined by Congress and repeated by the Supreme Court in the *Investment Company* decision would be present to a certain degree as long as a bank holding company has a "salesman's stake" in the fund. If the advisory fee is set, as it usually is, as a specified percentage of the assets managed, the advisor (and its bank affiliate) might have an incentive to push sales of fund shares to increase the fund's assets. Some danger of distorted investment advice and unsound loans to bank customers for the purchase of fund shares might exist under this type of arrangement. Such potential hazards might be lessened if the bank holding company's investment advisory subsidiary were compensated by the investment company on a basis unrelated to the size of the investment company's assets.[7]

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[6] Interlocking directorates between the fund and the advisor or any of its affiliates would raise a serious question as to the *de facto* independence of the fund's management.

[7] To the extent that an increase in fund assets would aid performance of the fund, *e.g.*, by permitting it to diversify investments, the bank holding company (and its bank affiliates) might have an incentive to push sales of fund shares even where the advisory fee was not based on fund size. This incentive would be based on the realization that the bank holding company's reputation and success in the advisory business will depend on the performance of those funds which it advises. Two other hazards mentioned by the Supreme Court, exploitation of commercial customers for the

CONCLUSION

The Board's proposal may have significant pro-competitive effects. However, before authorizing bank holding companies to engage in advising investment companies, the Board should make sure that the relationship authorized, including compensation arrangements, would not place the holding company's member bank affiliate in violation of the broad prohibitions of the Glass-Steagall Act so recently reaffirmed by the Supreme Court.

Respectfully submitted,

/s/ Richard W. McLaren
RICHARD W. MCLAREN
Assistant Attorney General

/s/ Barry Grossman
BARRY GROSSMAN

/s/ Daniel R. Hunter
DANIEL R. HUNTER

/s/ Neil E. Roberts
NEIL E. ROBERTS
Attorneys
Department of Justice
Washington, D.C. 20530

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benefit of the fund and unsound loans to companies in which the fund invested, might also exist regardless of the advisory fee arrangement since the advisor would have a continued interest in the performance of the fund. However, such potential hazards would seem to be no greater than these which exist in any situation in which a bank provides investment advice.

STATE BOND AND MORTGAGE COMPANY

[SEAL]

28 North Minnesota Street
New Ulm, Minnesota 56073
(507) 354-2144

September 24, 1971

Board of Governors
Federal Reserve System
Washington, D.C. 20549

Re: Proposed Amendment to Regulation 222 to Allow Bank Holding Companies to Engage in the Business of Acting as an Investment Advisor to Mutual Funds

Gentlemen:

State Bond and Mortgage Company, 23 North Minnesota, New Ulm, Minnesota, is a bank holding company by virtue of the provisions of the 1970 Amendment. It is alsc an investment advisor to three mutual funds, and we support the proposed amendment to Regulation 222. As we all know, the comptroller of the currency approved of national banks operating "mutual funds" under the auspices of collective agency accounts. While the Supreme Court held that this was not a proper activity for a national bank, it should be noted that the Court based its decision on the language in Section 16 of the 1933 Banking Act which referred to "underwriting, issuing, selling and distributing" securities, rather than a determination in that case that affiliation per se was illegal.

The Court further referred to the hearings on the 1933 Banking Act and recited the evils that the Act was intended to prevent. It cited as main purposes of the 1933 Banking Act, protection of the capital of banking corporations, prevention of unsafe loans, dealings by banks and speculative securities, and possible loss of con-

fidence by the public in banks generally, were banking institutions to recommend certain investments (namely those sold by affiliates).

It was specifically acknowledged by the Court that banking institutions may, and do, engage in purchases and sales of securities through their trust departments. No language in the opinion could be read to limit such authority.

It is obvious, therefore, that the Court placed the greatest emphasis not on the fact of investing as an illegal activity, but rather the promotional nature which may cause certain profits to accrue to the bank at the expense of the banking industry and public as a whole.

Since banks do manage funds and advise clients in trust accounts, such activities must of necessity be closely related to the banking business. The Board of Governors of the Federal Reserve System has previously approved bank holding companies acting as an investment advisor for individuals, again indicating that there is nothing prohibiting investment advisory activities as being closely related to banking.

Since the passage of the Banking Act of 1933, Congress has placed very significant restrictions on mutual funds and other investment companies through the Investment Company Act of 1940, and the amendments thereto. The most recent amendments, of 1970, place upon the investment advisor substantially similar restrictions to those placed upon trusts and trust officers dealing with their trust accounts, i.e. fiduciary responsibility towards the shareholders of the mutual funds. Courts have recently shown an increasing willingness to expand the concept of fiduciary relationship for advisors to a point beyond that of tradition common law concepts using the language of the 1940 Act. See *Moses* v. *Bergin* (First Circuit) decision as amended June 23, 1971 (CCH 93,061), and *Rosenfeld et al.* v. *Black, et al.*, CCA (2nd Cir.) decision June 22, 1971 (CCH 93,093).

There is no present legal prohibition under the Banking Act of 1933 prohibiting investment advisory activities, and banks themselves have engaged in such activities for many years. Investment advisors now have similar fiduci-

ary standards as bank trustees, and when performing similar functions. The Investment Company Act of 1940 regulates all aspects of investment advisory activities in such a manner as to prevent harm from the investment advisor.

Thus, there is no legal or public policy reason for prohibiting bank holding companies from acting as investment advisors to mutual funds, and we would urge the adoption of the proposed amendment to Regulation 222.

Sincerely,

STATE BOND AND MORTGAGE COMPANY

By /s/ Thomas P. Donnelly, Jr.
THOMAS P. DONNELLY, JR.
General Counsel

TPD:dc

cc. Minneapolis Office
Federal Reserve System

[SEAL]

THE AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Executive Director
Charles R. McNeill
202-467-4087

September 24, 1971

Mr. Tynan Smith
Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Secretary:

In accordance with the notice published in the *Federal Register* on August 25, 1971, by the Board of Governors of the Federal Reserve System, The American Bankers Association is submitting its comments on the Board's proposal to amend Section 222.4(a) of Regulation Y so as to permit a bank holding company to serve as an investment adviser to an investment company.

Our Association concurs with the Board's determination that "serving as investment adviser to an investment company under the Investment Company Act of 1940" is so closely related to banking as to be a proper incident thereto and thus a permissible activity to be engaged in by bank holding companies under Section 4(c)(8) of the Bank Holding Company Act. We therefore support its inclusion in subparagraph (5) of Section 222.4(a) of Regulation Y as proposed by the Board.

The fact that this type of activity is closely related to banking and is consistent with the traditional role of banks in serving fiduciary customers is clearly evidenced. For well over a century, banks and trust companies in every state have managed and administered customers investment funds in the form of trusts, estates and agency accounts. In addition, it is our understanding

that a number of banks are currently providing an advisory service of the kind authorized by the Board for mutual funds.

That the Board's proposal is consistent with Congressional intent and understanding is also readily apparent from the statutory language used in the Investment Advisers Act of 1940. Under Section 202(a)(11) of that Act, the Congress specifically excluded banks and bank holding companies from the definition of "investment adviser" in the context of an investment adviser required to register under the Act. Thus, as a result of the exclusive inference, it is quite clear that the Congress assumed and contemplated that banks and bank holding companies may and do, for compensation, engage in the business of acting as investment advisers.

It is understood that under Section 3(c)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(1), the Securities and Exchange Commission registration and disclosure requirements do not apply to a domestic entity if its outsanding securities are beneficially owned by not more than 100 persons and it does not propose to make a public offering of its securities. Also, it is understood that a foreign company (an offshore fund) can not register under the Investment Company Act of 1940. Apparently, some American banks, either directly, or through affiliates, are engaged in furnishing investment advisory services to such companies. In view of this situation, we question whether the proposed amendment to Regulation Y which is limited to "serving as investment adviser to an investment company under the Investment Company Act of 1940," should not be broadened to include the above companies.

By way of clarification, however, we would urge the Board to make one additional point in the final regulation. As proposed, the Board's amendment does not define either the term "investment adviser" or the range of services which may be provided by a bank holding company acting as an investment adviser. In most instances, in addition to the adviser's primary function of furnishing a continuous investment program to an investment company, it customarily undertakes and is often expected

to provide other ancillary services of a management nature. These services often include purchasing or selling securities or being empowered to determine what securities should be purchased or sold by the investment company, acting as sponsor of the fund, pricing agent in the determination of the funds net asset value and other "housekeeping" functions.

In our judgment, it is imperative that the Board's regulation include both adviser and management functions in order for bank holding companies to actively compete with non-bank advisers in servicing investment companies and to adequately protect the interests of such companies' investors.

The Investment Company Act of 1940 recognizes this and defines an investment adviser as including both advisory and management functions. Accordingly, we would suggest and urge the Board to adopt and apply the definition of "investment adviser" as found in that Act.

In summary, The American Bankers Association supports the Board's proposal to permit bank holding companies to serve as investment advisers and, we would further recommend that the Board clarify or modify its proposed regulatory authorization by adopting the definition of the term "investment adviser" now used in the Investment Company Act of 1940.

Sincerely yours,

/s/ Charles R. McNeill
CHARLES R. MCNEILL
Executive Director
Government Relations

APPENDIX

Factual Supplement

The purpose of this Appendix is to summarize various salient facts concerning the relationships between the 19 investment companies listed in Part I, *supra*, and the bank holding company affiliates associated with them. This summary is based on numerous documents filed by the companies with the Securities and Exchange Commission, all of which are set forth as exhibits to the Affidavit of James W. Jones accompanying this Memorandum.

In its interpretive ruling accompanying the amendment of Regulation Y, the Federal Reserve Board concluded that where a relationship of sponsorship and control exists between a bank holding company (or its affiliates) and an investment company, the entire complex must be viewed as a single entity for Glass-Steagall Act purposes. The facts in the present case clearly demonstrate that such a relationship exists with respect to the 19 investment companies we have examined. Indeed, in the case of seven of the investment companies, the sponsorship of the bank holding company or its affiliate is freely admitted. Thus, Overland Income Securities, Inc. openly states in its SEC registration statement:

> Although Registrant presently has no stock issued or outstanding, Registrant's organization has been sponsored by Wells Fargo Bank, National Association . . . a wholly owned subsidiary of Wells Fargo & Company. [Overland Income Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Item 13.]

Similarly, Vestaur Securities, Inc., explicitly states in its SEC filing:

> Registrant has no shares of its Common Stock presently outstanding. Registrant has been organized under the sponsorship of First Pennsylvania Corporation, the parent of Vestaur Corporation who will act as the investment adviser to the Registrant. [Vestaur Securities, Inc., Registration Statement of

Management Investment Company (Form N-8B-1, Item 13.] [1]

A tacit admission of sponsorship and control can also be found in the fact that in 10 of the 19 cases, the bank holding company affiliates involved have agreed to indemnify the underwriters participating in the distribution of the funds' shares against certain liabilities, including liabilities under the Securities Act of 1933. These ten companies include eight in which sponsorship by a bank or bank-affiliated institution is not openly acknowledged. Moreover, in the case of eight of the funds the indemnification of underwriters has been undertaken directly by the banks themselves rather than by affiliated companies. Typical of these idemnification arrangements is the following provision from the purchase agreement among Peachtree Equity Securities, Inc.; its investment adviser, Citizens and Southern Investment Counseling, Inc.; and its underwriters:

> The Company and the Adviser jointly and severally agree to indemnify and hold harmless each Underwriter and each person, if any, who controls any Underwriter within the meaning of Section 15 of the Securities Act, as follows:
>
> > (i) against any and all loss, liability, claim, damage and expense whatsoever arising out of any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (or any amendment thereto), or the omission or alleged omission therefrom of a material fact required to be stated therein or necessary to make the statement therein nor misleading or arising out of any untrue statement

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[1] Similar admissions of sponsorship may be found in the Form N-8B-1 filings of Invesco Income Fund, Inc. and Invesco Equity Fund, Inc. (admitting sponsorship by Citizens and Southern National Bank of Atlanta); Montgomery Street Income Securities, Inc. (admitting sponsorship by BankAmerica Corporation); Current Income Shares, Inc. (admitting sponsorship by Union America, Inc.); and Excelsior Income Shares, Inc. (admitting sponsorship by UST Advisory Company, Inc.).

or alleged untrue statement of a material fact contained in any preliminary prospectus or the Prospectus (or any amendment or supplement thereto) or the omission or alleged omission therefrom of a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, unless such statements or omission or such alleged statement or omission was made in reliance upon and in conformity with written information furnished to the Company by any Underwriter through you expressly for use in the Registration Statement (or any amendment thereto) or such preliminary prospectus or the Prospectus (or any amendment or supplement thereto);

(ii) against any and all loss, liability, claim, damage and expense whatsoever to the extent of the aggregate amount paid in settlement of any litigation, commenced or threatened, or of any claim whatsoever based upon any such untrue statement or omission, if such settlement is effected with the written consent of the Company or the Adviser, as the case may be; and

(iii) against any and all expense whatsoever reasonably incurred in investigating, preparing or defending against any litigation, commenced or threatened, or any claim whatsoever based upon any such untrue statement or omission, or any such alleged untrue statement or omission, to the extent that any of such expense is not paid under (i) or (ii) above. [Peachtree Equity Securities, Inc., Registration Statement under Securities Act of 1933 (Form S-5), Exhibit G (2).]

Further indication of bank sponsorship and control may be found in the fact that in six cases all organizational expenses of the investment companies, including all costs and expenses arising in connection with the companies' incorporation and their initial registration and qualifica-

tion under applicable federal and state securities laws, are to be borne by the bank holding company affiliate concerned. In two additional cases, such organizational costs will be paid by the banks or bank affiliates only if the initial offerings of the funds' shares are not completed.

Even where sponsorship and control are not readily apparent at the organizational stage, however, there is invariably strong indication that such a relationship exists. Thus, it should be noted that the function of the investment adviser in each of the 19 cases far exceeds the mere rendering of advice. In each instance, the adviser is empowered to manage the investment operations of the company it serves and its portfolio. The adviser not only makes investment decisions for the company, it also places purchase and sale orders for portfolio transactions, usually selects the broker-dealers with whom the company transacts business, and performs a variety of other administrative and management functions. As one investment company put it:

> [T]he Adviser will provide the [Company] with an investment program complying with the investment objectives, policies and restrictions of the [Company] and in carrying out such program, will be responsible for the investment and reinvestment of the [Company's] assets. The Adviser will perform and bear the cost of research, statistical analysis and *continuous complete supervision of the [Company's] investment portfolio.* [Vestaur Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Item 22(c) (emphasis added).]

Typical of the authority conferred on bank or bank-affiliated investment advisers by the investment companies they serve are the following provisions from the Investment Advisory Agreement between Meridian Income Securities, Inc. and The Indiana National Bank:

> The Company hereby retains the Adviser to act as investment adviser to the Company and to supervise and manage the investment activities of the Company as hereinafter set forth. Without limiting the generality of the foregoing, the Adviser shall obtain and

evaluate such information and advice relating to the economy, industries, businesses, securities markets and securities as it deems necessary or useful to discharge its duties hereunder; shall formulate a continuing program for the management of the assets of the Company; shall determine the securities to be purchased, sold or otherwise disposed of by the Company and the timing of such purchases, sales and dispositions; and shall take such further action, including the placing of purchase and sale orders on behalf of the Company as the Adviser shall deem necessary or appropriate for the implementation of such program. The Adviser shall also furnish to or place at the disposal of the Company such of the information, evaluations, analyses and opinions formulated or obtained by the Adviser in the discharge of its duties as the Company may, from time to time, reasonably request.

The Adviser shall, at its own expense, maintain such staff and employ or retain such personnel and consult with such other persons as it shall from time to time determine to be necessary or useful to the performance of its obligations under this Agreement. Without limiting the generality of the foregoing, the staff and personnel of the Adviser shall be deemed to include persons employed or otherwise retained by the Adviser to furnish statistical and other factual data, advice regarding economic factors and trends, information with respect to technical and scientific developments, and such other information, advice and assistance as the Adviser may desire. The Adviser shall, as agent for the Company, maintain the Company's books of account (other than those maintained by the Company's transfer agent, registrar, custodian and other agents). All such books and records so maintained shall be the property of the Company and, upon request therefor, the Adviser shall surrender to the Company any books and records so requested.

* * * *

The Adviser shall bear the cost of rendering the investment management and supervisory services to

> be performed by it under this Agreement, and shall, at its own expense, pay the compensation of the officers and employees of the Company and provide such office space and equipment and such clerical and bookkeeping services as the Company shall reasonably require in the conduct of its business, together with the cost of telephone service, heat, light, power and other utilities. The Adviser agrees to advance registration fees in connection with initial Federal and state registration of Company shares and to assume sole responsibility for such fees unless and until any or all of such shares are sold, and the Company agrees to reimburse the Adviser for amounts so advanced out of the proceeds of the initial public offering of the Company's shares. [Meridian Income Securities, Inc., Registration Statement under the Securities Act of 1933 (Form S-4), Exhibit 5.]

Likewise, the Investment Advisory Agreement between Circle Income Shares, Inc. and American Fletcher National Bank and Trust Company provides, in relevant part, as follows:

> In acting as investment adviser and rendering investment supervisory services to the Company, the Adviser shall obtain and evaluate such information relating to the economy, industries, businesses, securities markets and securities as it may deem necessary or useful in the discharge of its obligations hereunder; shall formulate a continuing program for the management of the assets and resources of the Company in a manner consistent with its investment objectives; shall from time to time make recommendations and furnish advice to the Company regarding securities to be purchased and sold by the Company, and the portion of its assets to be held in cash or cash equivalents, in order to carry out such program; and generally shall take such other steps as the Adviser may deem necessary or appropriate to supervise the implementation by the Company of such program, recommendations and advice. The Ad-

viser shall also furnish to or place at the disposal of the Company such of the information, reports, evaluations, analyses and opinions formulated or obtained by the Adviser in the discharge of its duties hereunder as the Company may, at any time or from time to time, reasonably request or as the Adviser may deem helpful to the Company.

In rendering corporate administrative services to the Company, the Adviser, at its expense, shall:

> (a) Furnish or provide to the Company such official personnel, and such clerical and bookkeeping services (exclusive of and in addition to any such services provided or furnished by any custodian, transfer agent or other institutional agent retained by the Company), as the Company may reasonably require in the conduct of its business, including the maintenance of the Company's accounts and records and the performance of all other functions necessary for the maintenance of its corporate existence and its shareholder relations; and
>
> (b) Furnish the services of individuals competent to perform all executive and administrative functions for the Company, including without limitation such functions related to the execution of portfolio transactions on its behalf as are not assigned to any other institutional agent retained by the Company . . . . [Circle Income Shares, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Exhibit 5.]

Not only are the bank and bank-affiliated advisers responsible for the operation of their investment companies, but in the case of 15 of the funds, the advisers also agree to bear certain excess operating costs incurred by the companies. Typical of these arrangements is the following excerpt from the Management and Investment Advisory Agreement between Montgomery Street Income Securities, Inc. and BA Investment Man-

agement Corporation (a subsidiary of BankAmerica Corporation):

> In the event the expenses of the Fund, including amounts payable to the Manager . . . for any fiscal year ending on a date on which this Agreement is in effect exceed one and one-half percent (1½%) of the first thirty million dollars ($30,000,000) of the average net assets of the Fund, plus one percent (1%) of the average net assets of the Fund in excess of $30,000,000 . . . the Manager will pay to the Fund the amount of such excess as soon as is practicable at the end of a fiscal year. [Montgomery Street Income Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Exhibit 5.]

Still another significant indicium of sponsorship and control may be found in the fact that in 17 of the 19 investment companies examined there are interlocking relationships between directors, officers, or employees of the fund and the bank or bank affiliate advising it. Moreover, the number of interlocking relationships in each case is not insignificant. A majority of officers and most employees of the various funds fall in this category, as well as a minority of fund directors.

Also of significance is the fact that in the case of two funds, the investment companies have obtained the right, through licensing agreements, to use the logos of the banking institutions which "sponsor" them. Likewise, in two additional cases, the name of the investment company itself is technically the property of the bank holding company complex associated with it. Further, 12 of the funds use their "sponsoring" banking institutions as custodians of the funds' portfolio securities or as transfer agents for the funds' own securities.

In each case, of course, the investment adviser is compensated for its services. Although the rates vary somewhat, the usual advisory fee is ½ of 1 percent of the fund's net asset value, computed periodically (typically on a monthly basis). This procedure, of course, ties the advisory fee indirectly to the fund's performance. How-

ever, in the case of at least one fund, Peachtree Equity Securities, Inc., this relationship is made even more explicit. Peachtree has adopted an elaborate fee computation system under which the base fee payable to its adviser may be increased or decreased in accordance with the performance of Peachtree's portfolio securities relative to the Standard & Poor's Index of 425 Stocks.

Based on the foregoing, it is clear, as a factual matter, that the 19 investment companies listed in Part I of this Memorandum are—at least at present—"arms" of the banking institutions associated with them in all but a strictly technical sense. Likewise, there is a clear pattern of close-knit management and supervision which compels the conclusion, in virtually every case, that the bank or bank-affiliated adviser, in effect, "controls" the fund which it serves.[2] Given these facts, it must be concluded —consistent with the Federal Reserve Board's own ruling —that each of the bank holding companies, its banking and nonbanking subsidiaries, and the investment companies associated with it, must all be regarded as a single entity for Glass-Steagall Act purposes.

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[2] It should be noted that this expansive concept of "control" is not foreign to the banking laws. For example, Section 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b), defines an "affiliate" of a Federal Reserve member bank as any corporation, business trust, association, or other similar organization with respect to which control is held "directly or indirectly, through stock ownership *or in any other manner*, by the shareholders of a member bank . . . ." (Emphasis added.) Similarly, the Federal Reserve Board, in the context of its responsibilities under the Securities Exchange Act of 1934, has defined the term "control" as meaning "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by *contract*, or otherwise" (emphasis added). 12 C.F.R. § 206.2(f). Likewise, the 1970 Amendments to the Bank Holding Company Act provide that one company controls another if it "exercises a controlling influence over [its] management or policies." 12 U.S.C. § 1841(a)(2)(C). Finally, "control" within the meaning of the Investment Company Act of 1940 is defined as "the power to exercise a controlling influence over the management or policies of a company . . . ." 15 U.S.C. § 80a-2(a)(9).

SUPREME COURT OF THE UNITED STATES

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER,

v.

INVESTMENT COMPANY INSTITUTE

ORDER ALLOWING CERTIORARI

Filed February 19, 1980

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted.

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Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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BRIEF FOR RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the Court of Appeals (App. A of Petition) is reported at 606 F.2d 1004.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED

Whether, under Section 4(c)(8) of the Bank Holding Company Act, the Federal Reserve Board may authorize bank holding companies and their non-bank subsidiaries to sponsor, organize and control closed-end investment companies.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions are set forth in Appendices F and G to the Petition.

STATEMENT

Respondent Investment Company Institute ("ICI") is the national association of open-end investment companies, their investment advisers and principal underwriters. This case arises out of ICI's successful challenge to a portion of a regulation and interpretive ruling which were promulgated by the Federal Reserve Board in light of this Court's decision in *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971).

In *Camp,* the Court addressed the following issue: "whether the Comptroller of the Currency may, consistently with the banking laws, authorize a national bank to offer its customers the opportunity to invest in a stock fund created and maintained by the bank." *Id.* at 621.[1] The Court held that the Comptroller had erred in determining the bank's involvement in the fund to be lawful. It stated: "We conclude that the operation of an investment fund of the kind approved

[1] As the Court noted: "Before 1963 national banks were prohibited by administrative regulation from offering this service." 401 U.S. at 621.

by the Comptroller involves a bank in the underwriting, issuing, selling, and distributing of securities in violation of §§ 16 and 21 of the Glass-Steagall Act." *Id.* at 639.

The Court premised its decision on several grounds, including the concern of Congress, when it enacted the Glass-Steagall Act, that public confidence in banks not be impaired by their association in any manner with opportunities for general investment:

> "A bank that operated an investment fund would necessarily put its reputation and facilities squarely behind that fund and the investment opportunity that the fund offered. The investments of the fund might be conservative or speculative, but in any event the success or failure of the fund would be a matter of public record. Imprudent or unsuccessful management of the bank's investment fund could bring about a perhaps unjustified loss of public confidence in the bank itself." *Id.* at 637.

The Court emphasized that, in enacting the Glass-Steagall Act:

> "Congress feared that the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence and restraint to the enterprise of selling particular stocks and securities, and that this could not be done without that reputation being undercut by the risks necessarily incident to the investment banking business." *Id.* at 632 (footnote omitted).

Following the *Camp* decision, on January 20, 1972 the Board promulgated the regulation and interpretive ruling that are in issue. It determined that, subject to certain conditions, bank holding companies and

their non-bank subsidiaries may act as investment advisers to various types of investment companies, including open-end investment companies, or "mutual funds." 12 C.F.R. § 225.125(c). However, in the case of open-end investment companies, the Board ruled that bank holding companies cannot lawfully do more than render investment advice: "In the Board's opinion, the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund." 12 C.F.R. § 225.125(f).

Thus, with respect to *open-end* investment companies, the Board extended the *Camp* prohibition against a bank's sponsoring an investment fund to bank holding companies and their non-bank subsidiaries. However, with respect to *closed-end* investment companies, the Board carved out an exception to the *Camp* prohibition on the theory that such companies typically are engaged in securities activities less frequently.[2] On this basis, the Board authorized bank holding companies and their non-bank subsidiaries to sponsor, organize and control closed-end investment companies. 12 C.F.R. § 225.125(f).

It was this aspect of the Board's ruling that ICI challenged in the Court of Appeals.[3] ICI asserted that bank holding company sponsorship of closed-end investment companies is no more lawful than sponsor-

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[2] In contrast with open-end investment companies, closed-end investment companies do not typically stand ready to redeem their shares at any time and, after initial organization, issue new shares less frequently.

[3] The procedural history of ICI's efforts to seek administrative or judicial relief with respect to the regulation in issue is adequately set forth in the Petition at pp. 7-8.

ship of open-end investment companies. ICI requested, therefore, that the Board be directed "to rescind amended Regulation Y insofar as it authorizes bank holding companies and their bank and non-bank subsidiaries to sponsor, organize or control closed-end investment companies."[4]

In response to ICI's petition, a unanimous panel of the Court of Appeals for the District of Columbia Circuit vacated the challenegd regulation. In so doing, the Court of Appeals carefully limited its decision to the issue before it. Judge McGowan's opinion, as amended, states:

> "The Board found . . . that bank holding companies could act as investment advisers to mutual funds so long as they did not sponsor, organize or control them. . . . Petitioner challenged even this limited authorization before the Board, . . . but has not renewed that argument on judicial review. . . . Under these circumstances, we do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies." App. A of Petition at pp. 8a, 48a-49a.[5]

The Court of Appeals therefore was not asked to address, and expressly did not address, the lawfulness of any banking institution's rendering solely investment

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[4] *See, e.g.*, Brief for Petitioner at p. 49; Reply Brief for Petitioner at p. 17.

[5] The final sentence of this quotation was added to the Court of Appeals' opinion by order entered *sua sponte* on July 13, 1979.

advice to investment companies or any other type of enterprise.

Petitioner's request for rehearing or rehearing *en banc* in the Court of Appeals was denied on July 16, 1979 after supplemental briefing by both parties at the request of the court below.[6]

ARGUMENT

The issue presented by this case—whether bank holding companies and their non-bank subsidiaries may lawfully sponsor, organize and control closed-end investment companies—is a narrow one, the immediate impact of which is strictly limited. The facts of record show that only four closed-end investment companies have been sponsored by the nation's 2,222 bank holding companies pursuant to the authority granted by the challenged regulation and ruling.[7] The four companies so sponsored do not represent a major segment of the investment company industry, which consists of approximately 1,000 registered investment companies.

This case does not in any sense involve a determination of the lawfulness of a banking institution's rendering solely investment advice to any investment company—and most certainly does not involve the law-

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[6] In connection with the petition for rehearing or rehearing *en banc* in the Court of Appeals, briefs were also submitted, although not accepted by the Court, on behalf of all but one of the *amici* who have appeared in support of the Petition for Certiorari.

[7] The Court of Appeals agreed with the Board's position below that the challenged regulation authorizes activities only by bank holding companies and their non-bank subsidiaries, and authorizes no activity at all by banks. App. A of Petition at pp. 22a-23a.

fulness of investment advice given to any other institutions. The Court of Appeals expressly stated:

> "[W]e do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render solely investment advice to closed-end investment companies . . . ." App. A of Petition, at pp. 48a-49a.

To the extent that Petitioner believes that the scope of permissible bank holding company activities—apart from sponsorship of closed-end investment companies—has been made unclear by the decision below, ICI respectfully submits that it would be appropriate for Petitioner to attempt to replace the challenged regulation with "one more narrowly drawn," as suggested by the Court of Appeals. Instead, Petitioner prematurely asks this Court to consider aspects of the regulation which were not challenged below and which the Court of Appeals, therefore, did not address.

On the narrow issue the Court of Appeals was asked to decide, and did decide, the decision below was manifestly correct. Section 4(c)(8) of the Bank Holding Company Act allows bank holding companies and their non-bank subsidiaries to engage in only a slightly wider range of activities than banking *per se*: that is, those activities determined by the Board "to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8). When Congress delegated to the Board responsibility to determine that particular activities are sufficiently "closely related to banking" to be permitted to bank holding companies, it did not intend

that the Board would allow bank holding companies to engage in the very activities that Congress, in the Glass-Steagall Act, expressly forbade to banks themselves. This view is supported by both the language of the Act and, as analyzed extensively in the Court of Appeals opinion, by the pertinent legislative history. Unless this Court's decision in *Camp* can be read as prohibiting bank sponsorship of only open-end investment companies, and not of closed-end companies —a distinction for which there is no support in the *Camp* decision—there is no lawful basis upon which the Board could properly authorize bank holding companies to sponsor, organize and control closed-end investment companies.

1. The Decision Below Involves A Narrow Legal Issue With Limited Immediate Impact

Petitioner points to the fact that there exists a variety of relationships between banks, banking-related organizations and different types of investment companies. In an attempt to invest this case with a broad public interest, Petitioner implies the probability of widespread repercussion in the banking and investment company industries if the decision below is sustained. For example, the Petition asserts that in 1976 "the largest 115 banks and their nonbank affiliates provided *some form of investment advice* to 159 investment companies . . . ." Petition at p. 11 n.12 (emphasis added.)[8]

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[8] The SEC study cited by Petitioner is not part of the record. Although it is unclear what the cited portion shows, it is clear that the study is not relevant to the issue raised in this case. It appears from the SEC material that 159 investment companies received "some form" of investment advice from banks and their non-bank affiliates. However, "advice" is not an issue in this case. The issue is *sponsorship*, which is not addressed by the SEC study.

Petitioner omits, however, to state the number of investment companies which actually have been sponsored, organized or controlled by bank holding companies or their non-bank subsidiaries pursuant to the challenged regulation. On the facts of record, there appear to be only four such investment companies.[9] *See, e.g.,* App. E of Petition at p. 67a.

As the Petition observes, there are over 2,200 registered bank holding companies in operation. There are approximately 1,000 registered investment companies. Nevertheless, between 1972, when the challenged regulation first became effective, and 1977, when ICI filed the applicable petition for reconsideration with the Board, only four bank holding companies had sponsored closed-end investment companies which operated at the time of the Petition.[10] Moreover, based upon the statistics and sources cited by Petitioner, the total net assets of the ten closed-end investment companies which are currently managed by any kind of banking organization—including the six advised by banks and therefore not authorized directly by the challenged regulation—amount to approximately only

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The SEC data do not show which, if any, of the investment companies involved in the study may have been sponsored by the banking institutions that responded to the SEC's questionnaire. As we note, the facts of record show that four investment companies were sponsored under the challenged regulation—not 159.

[9] The record also contains evidence that eight additional closed-end investment companies had been sponsored by bank subsidiaries of bank holding companies. *See, e.g.,* App. E of Petition at p. 67a. As noted, the Board denies that the challenged regulation authorizes this activity by banks. *See* n. 7, *supra.*

[10] It should be noted that, if other bank holding companies had any commercial urge to enter the investment company business, they easily could have done so. The statutory requirements for entry into the business under the Investment Company Act are not burdensome. *See, e.g.,* 15 U.S.C. §§ 80a-9(a) and 80a-14(a).

one percent of the total assets of registered investment companies in the United States.

Thus, while the Petition claims that "[b]y prohibiting bank holding companies from organizing closed-end investment companies, the decision of the court of appeals will curtail the creation of new closed-end companies" (Petition at p. 12 (footnote omitted)), as a practical matter any adverse competitive impact will not be great. Moreover, whether or not the impact of the prohibition can be justified to further other important social policies is not a judgment Petitioner is free to make; Congress has already addressed the issue, as this Court noted in *Camp,* and made a dispositive determination:

> "The Glass-Steagall Act reflected a determination that policies of competition, convenience, or expertise which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the 'hazards' and 'financial dangers' that arise when commercial banks engage in the activities proscribed by the Act." 401 U.S. at 630 (footnote omitted).

Congress has shown no disposition to change this policy, although it has periodically re-examined the issue of bank involvement in the securities business. *See, e.g.,* Securities Subcommittee of Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., Securities Activities of Commercial Banks—Study Outline (Comm. Print 1975).

II. The Petition Should Not Be Granted To Review Issues Which Were Not Raised, Argued Or Decided Below

Petitioner observes that "[a]s a part of their ordinary banking business, banks have traditionally pro-

vided a wide range of fiduciary and financial advisory services that involve transactions in securities." Petition at p. 10. The *amici* herein argue that the Court of Appeals decision "has needlessly cast a shadow over a broad spectrum of services that historically have constituted a significant part of the business of many banks of all sizes, including especially customary investment management and advisory services." Memorandum of the American Bankers Association As *Amicus Curiae* at p. 3. However, in its present posture, this case does not involve the lawfulness of the rendering of investment advice or any other traditional "fiduciary" activity of banks with respect to investment companies—much less with respect to real estate investment trusts, small business investment companies or pooled employee benefit plans.[11] *See* Petition at p. 13.

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[11] We note that some individual members of the banking organizations appearing as *amici* apparently consider the decision as having a rather less broad impact than that suggested by the briefs of the *amici* in this Court. For example, on June 5, 1979, Citibank, N.A.—one of the twelve members of the New York Clearing House Association—stated the following with respect to the scope of the Court of Appeals decision:

> "In view of the limited focus of the analysis, it seems reasonable to conclude that the regulation and ruling were vacated because they permitted bank holding companies and their non-bank subsidiaries to sponsor, organize or control funds. There is no indication that the court intended to preclude bank holding companies and their subsidiaries from advising funds which they do not operate, whether open-end or closed-end." Letter from Patrick J. Mulhern, Vice President, Citibank, N.A. to John E. Shockey, Esq., General Counsel, Comptroller of the Currency, dated June 5, 1979 at p. 4.

Similarly, MoneyMart Assets, Inc.—an investment company advised by Continental Illinois National Bank and Trust Company of Chicago—states in its current Prospectus that, in the opinion of its counsel, the decision below does "not apply to bank or non-bank subsidiaries of bank holding companies which act as investment advisers to either closed-end or open-end investment com-

In *Camp*, this Court held that federal banking legislation prohibited a *bank* from directly sponsoring an investment fund that operated like an investment company. Subsequent to *Camp*, and, we submit, correctly applying the principles of that decision, the Board promulgated a regulation which it interpreted as prohibiting bank holding company sponsorship of open-end investment companies. Simultaneously, however, the Board purported to authorize bank holding company sponsorship of closed-end investment companies. It was this aspect of the Board's position that ICI challenged in the Court of Appeals.

This case does not involve the rendering of solely investment advice by banking institutions. The challenged regulation and interpretive ruling explicitly authorized *sponsorship* by bank holding companies of closed-end investment companies. The bank holding companies that acted pursuant to the authority of the regulation explicitly acknowledged *sponsorship* of the closed-end companies in question in their filings with the Securities and Exchange Commission. *See* Record at 1246, 1512 and 2162. The Court of Appeals decision explicitly addresses only the issue of *sponsorship*:

> "[W]e do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies." App. A of Petition at pp. 48a-49a.

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panies which they do not sponsor, organize or control." Prospectus filed with the Securities and Exchange Commission dated April 19, 1979 (File No. 2-55301) at 16.

To be sure, there may be instances where sponsorship exists by reason of the facts of a particular case, even though sponsorship is not expressly admitted.[12] This is especially true in the investment company industry, where, as the Board has acknowledged, investment companies are traditionally sponsored by their investment advisers. 12 C.F.R. § 225.125(e). However, further review of this case will not help to elucidate the limits of sponsorship. Here, sponsorship was expressly authorized by the challenged regulation and ruling, and sponsorship was expressly acknowledged by the bank holding companies that acted pursuant to the regulation. The limits of "sponsorship" are not in contention.

If, notwithstanding the explicit limitations the Court of Appeals placed upon its holding, either the Board or the *amici* herein still perceive that the decision "leaves in its wake an unsettled regulatory climate" (Memorandum of the American Bankers Association As *Amicus Curiae* at p. 3), we respectfully suggest that the Board might accept the invitation of the Court of Appeals to promulgate a new regulation with respect to investment advice which does not authorize sponsorship of closed-end investment companies. In

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[12] The existence of a contractual advisory relationship establishing full discretionary investment management authority and its ordinary incidents might be one factor, among others, to be considered in determining, on the facts of a particular case, whether a bank holding company goes beyond simply acting as an investment adviser and actually sponsors, organizes or controls an investment company. However, Petitioner sets up a straw man insofar as it argues that the Court of Appeals may have intended *per se* to prohibit discretionary investment management by deciding that bank holding companies may not sponsor closed-end investment companies. *See* Petition at p. 12. The Court of Appeals decision merely places closed-end investment companies on the same footing as open-end investment companies in this regard.

doing so, the Board could, if it chose, hold a hearing to obtain all pertinent facts, and weigh them in applying its acknowledged expertise. Such facts are more readily obtainable by the Board than by this Court. Certainly, this Court should not grant certiorari to decide in the first instance a variety of complex issues pertaining to federal banking legislation which the Court of Appeals was not asked to address; which the Court of Appeals expressly refrained from addressing; and which could not be addressed on the record in this proceeding.

III. The Decision Below Is Clearly Correct

With respect to the issue the Court of Appeals was asked to reach and did reach—that is, whether bank holding companies may lawfully sponsor closed-end investment companies—the decision below is clearly correct.

After a searching examination and analysis of the legislative history, a unanimous panel of the Court of Appeals, speaking per Judge McGowan, found that Section 4(c)(8) of the Bank Holding Company Act does not permit the Federal Reserve Board to authorize the sponsorship, organization and control of closed-end investment companies by bank holding companies. While in relying on Section 4(c)(8), the Court of Appeals decided the case on an alternative ground suggested by ICI, the significance of Section 4(c)(8) was briefed fully in connection with Petitioner's petition for reconsideration in the Court of Appeals.[13] Most importantly, the result is clearly the right one.

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[13] The Court of Appeals did not accept ICI's contention that Sections 16 and 21 of the Glass-Steagall Act directly prohibit the sponsorship of closed-end investment companies by bank holding

1. The Court of Appeals' decision, contrary to Petitioner's assertions, has the merit of conforming to the plain meaning of the statutory language and to common sense. It is simply incongruous to suggest, as does Petitioner, that Congress could have intended that activities which are expressly forbidden to banks by statute can nonetheless "be so closely related to banking . . . as to be a proper incident thereto."

National banks have always been limited to the exercise of only those powers expressly conferred upon them or those which are necessarily incidental to the kind of banking which they are authorized to transact. *See, e.g., First National Bank* v. *Missouri,* 263 U.S. 640 (1924). However, after the experience of the Great Depression, Congress was no longer satisfied that the traditional doctrine of *ultra vires* was sufficient to protect the public in the case of securities activities by banks. When Congress passed the Glass-Steagall Act in 1933, it reached out *explicitly to prohibit* securities activities by banks and their affiliates. The background of the Glass-Steagall legislation

> "conclusively demonstrates that it was the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities." *Baker, Watts & Co.* v. *Saxon,* 261 F. Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.,* 392 F.2d 497 (D.C. Cir. 1968).

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companies. Instead, the Court of Appeals found the Glass-Steagall Act relevant only insofar as it serves to inform the meaning of Section 4(c)(8) of the Bank Holding Company Act. ICI did, however, argue below that the challenged activity could not lawfully be authorized under the Bank Holding Company Act. ICI reserves its right to argue that either statutory basis would properly support the result below.

As this Court held in *Camp*, Congress intended Sections 16 and 21 of the Glass-Steagall Act to prohibit banks from sponsoring investment funds.

In the Bank Holding Company Act of 1956, Congress enacted for the first time a detailed and comprehensive system of bank holding company regulation with respect to non-banking activities of all kinds which were then being conducted through the bank holding company device. The Bank Holding Company Act required bank holding companies to divest themselves of *all* their non-banking businesses, except insofar as expressly authorized by various specific exceptions in the Act.

Section 4(c)(8) of the Act, as amended, is such an exception. It allows bank holding companies and their non-bank subsidiaries to engage in a slightly wider range of activities than banking *per se*: that is, those activities determined by the Board "to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843 (c)(8). However, surely activities which are *expressly forbidden* to banks—and not merely *ultra vires*—cannot reasonably be construed as being "so closely related to banking, . . . as to be a proper incident thereto."

2. The Court of Appeals decision is solidly grounded on the legislative history. Petitioner's arguments to the contrary are without merit.[14]

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[14] Petitioner's suggestion that Section 4(c)(7) of the Bank Holding Company Act authorizes the operation of a closed-end investment company reflects "appellate counsel's *post hoc* rationalizations for agency action . . . ." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 628 (1971), quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962). In the

Contrary to Petitioner's assertions, Section 20 of the Glass-Steagall Act is not the relevant provision with which to interpret the lawfulness of securities activities engaged in by bank holding companies and their non-bank subsidiaries under the Bank Holding Company Act. In the first place, as the Board conceded below, Section 20 did not apply to bank holding companies and their non-bank affiliates when the Bank Holding Company Act was enacted in 1956, and could not have become applicable until at least ten years later. *See* Petition for Rehearing and Suggestion for Rehearing *En Banc* at pp. 7-8. Yet the limitations on the securities activities which are permitted to bank holding companies remain the same today as when the legislation was first enacted in 1956. When the Bank Holding Company Act was amended in 1970, the legislative history made it clear that the Congress resolved "that bank holding companies were not to engage in the securities business beyond what was permitted in the 1956 Act." App. A of Petition at 36a.[15]

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administrative proceeding before it, the Board never placed reliance on this provision. Moreover, as the legislative history of the 1956 predecessor of Section 4(c)(7) makes clear, all that section does is permit a bank holding company to make certain of the same investments indirectly through a corporate subsidiary that it could itself make directly. *See* 102 Cong. Rec. 6128 (1956) (remarks of Senator Barkley). Section 4(c)(7) was intended to be a narrow, "technical amendment," *see id.* at 6130 (remarks of Senator Robertson), drafted with a specific bank holding company and wholly-owned subsidiary in mind, *see id.* at 6131 (same). The ownership of a subsidiary investment company is a far different activity from the sponsorship of a closed-end investment company whose shares are issued, offered, sold, and distributed to the *public*. It is the latter activity that is not authorized to bank holding companies by Section 4(c)(8).

[15] Before it was determined to leave the 1956 standard intact, there was some controversy between the Senate and the House concerning the permissibility of securities activities under a

Moreover, even if Section 20 ultimately became applicable to bank holding companies,[16] it should be emphasized that Section 20 does not *authorize* any activity; it *prohibits* certain securities activities by affiliates of member banks. It is of no consequence that Section 20 may not explicitly prohibit *all* the activities which fail to meet the "closely related to banking" standard of Section 4(c)(8).

In short, the legislative history of Section 4(c)(8) and its predecessor compels the same conclusion as that mandated by the plain meaning of the statute. The Board lacks the power to authorize as "closely related to banking," within the meaning of Section 4(c)(8), activities, such as the sponsorship of closed-end investment companies, that Congress has expressly forbidden to banks. The result reached by the Court of Ap-

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revised Section 4(c)(8). However, the legislative history cited in the Petition at pp. 17-18 & n.25 evidences nothing more than that Congress was aware of the then-pending litigation with respect to the Comptroller's regulation authorizing bank-operated commingled agency accounts. This Court ultimately held that regulation unlawful in *Camp*.

[16] In 1966 the definition of "affiliate" in Section 2(b) of the Glass-Steagall Act, *codified as amended*, 12 U.S.C. § 221a(b), was amended to include a provision substantially similar to the repealed Section 2(c) definition of "holding company affiliate," *see* 80 Stat. 242 (1966). It is unlikely that Congress intended by this amendment to make Section 20 applicable to bank holding companies. This possible consequence of its actions certainly went unnoticed by Congress. The purpose of expanding the Section 2(b) definition was, rather, to save from the general repeal of the holding company affiliate provisions certain provisions of the Federal Reserve Act relating to reports on holding company affiliates and to render applicable to holding company affiliates other provisions of the Federal Reserve Act relating to examinations of affiliates of member banks. See S. Rep. No. 1179, 89th Cong., 2d Sess. 12-13 (1966); Senate Comm. on Banking and Currency, 89th Cong., 1st Sess., Analyses of S. 2353, S. 2418, & H.R. 7371 at 19 (Comm. Print 1965).

peals is the only one consonant with the purpose of Section 4(c)(8) to further the Glass-Steagall Act goal "of divorcing investment from commercial banking." App. A of Petition at p. 30a. Despite Petitioner's attempt to portray sponsorship of investment companies as similar to various fiduciary and financial advisory services, involving securities, in which banks have traditionally engaged, the Court of Appeals saw the obvious distinction between fiduciary activities and the sponsorship of an investment company whose shares are marketed to the general public. This Court drew the same distinction in *Camp*:

> "No provision of the banking law suggests that it is improper for a national bank to pool trust assets, or to act as a managing agent for individual customers, or to purchase stock for the account of its customers. But the union of these powers gives birth to an investment fund whose activities are of a different character." 401 U.S. at 624-25.

3. The Court of Appeals accorded appropriate deference to the Board's expert discretion, to the extent possible in the face of the overwhelming evidence of contrary legislative intent.

The Court of Appeals expressly noted and considered the "high degree of deference" to which the Board's construction of the Act would ordinarily be entitled in light of this Court's decision in *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978). However, speaking for the unanimous panel of the Court of Appeals, Judge McGowan also noted that the court could not abdicate its duty in the final instance to say what the law is:

> "The rulemaking power granted to an administrative agency charged with the administration

> of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by statute.'" *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 213-14 (1976) (citations omitted).

The Court of Appeals' conclusion was "emphatically that section 4(c)(8) does not empower the Board to authorize conduct of the type at issue here." App. A of Petition at pp. 24a-25a.

Consistent with *First Lincolnwood,* however, the Court of Appeals carefully limited its ruling and virtually invited the Board to attempt to reformulate a lawful regulation:

> "[W]e do not reach, and are not to be taken as expressing any view on, the question whether bank holding companies and their non-bank subsidiaries may, either under the present regulations *or one more narrowly drawn,* render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies." App. A of Petition at p. 48a (emphasis added).

To date, the Board has not accepted the Court of Appeals' invitation to attempt to clarify the scope of permissible activities. Instead, it asks this Court to provide such guidance in the first instance. For the reasons stated *supra,* ICI submits that a writ of certiorari should not issue for this purpose.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 79-927

In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

WADE H. McCREE, JR.
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Washington, D.C. 20530

In the Supreme Court of the United States

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REPLY MEMORANDUM FOR THE PETITIONER

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1. Respondent argues (Br. in Opp. 8-10) that the practical consequences of the decision below are "limited" and that "any adverse competitive impact will not be great." However, the court of appeals' decision has an immediate impact on bank holding companies now serving as investment advisers to closed-end investment companies, as well as on the shareholders of those companies. It also has an impact on other bank holding companies that do not now serve as investment advisers but may wish to do so in the future. Furthermore, respondent's argument about practical consequences fails to consider that the rationale of the decision below calls into serious question the permissibility of investment management activities by banks. As we have explained (Pet. 11 & n.12), banking organizations traditionally have provided investment

management services to closed-end investment companies. Despite the deterrent effect of the present litigation, fully one-third of the major closed-end investment companies that were organized after the effective date of the Board's regulation were organized by banking institutions.[1] A reversal of the decision below would permit significant new entry by both banks and bank holding companies, resulting in a substantial increase in actual and potential competition.

Respondent further understates the impact of the decision of the court of appeals by arguing that its holding reaches only "sponsorship" of closed-end investment companies (Br. in Opp. 12). Respondent overlooks the language of the opinion, which clearly states that the court's holding prohibits "sponsoring, organizing, managing, or controlling such companies" (Pet. App. 49a). The only issue left undecided by the court of appeals is the permissibility of providing mere "advice" to closed-end investment companies, apart from the forbidden control, management, sponsorship, or organization. For this reason, the Board's authority to adopt a new regulation is severely curtailed.

In sum, by adopting an erroneous and unduly restrictive construction of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), the court of appeals has barred the Board from authorizing bank holding companies to perform services that are closely related to the service of portfolio management customarily provided by banks, a result that is contrary to the mandate of Congress. In addition, by defining the scope of activities permissible to bank holding companies

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[1]See Wiesenberger, *Investment Companies Service*, "Management Results" 572-575 (September 1979). Respondent repeatedly argues that such management activities by banks are illegal (see Br. in Opp. 8, 15, 16, 18).

by reference to vague standards of securities-relatedness—instead of relying on the literal language of the Glass-Steagall Act and the Bank Holding Company Act—the decision below obscures the dividing line between the securities and banking industries and deprives those industries of effective guidance in the conduct of their operations.

2. Respondent's central argument in support of its assertion that bank holding companies may not manage closed-end investment companies is that such activities are "expressly forbidden to banks" (Br. in Opp. 7-8, 15-16, 18).[2] This argument is both erroneous and irrelevant. It is erroneous because the Glass-Steagall Act does not forbid banks to manage closed-end investment companies within appropriate limitations. And it is irrelevant because both the Glass-Steagall Act and the Bank Holding Company Act permit bank holding companies to engage in a substantially broader range of activities than banks.

a. The activities authorized to bank holding companies by the Board's regulation are not forbidden to banks under the Glass-Steagall Act. The Board's regulation imposes numerous restrictions designed to keep the authorized activities within the ambit of lawfulness under the Glass-Steagall Act. See 12 C.F.R. 225.125(d)-(i). Those restrictions—which effectively divorce investment management from the underwriting process and protect against conflicts of interest—are described in the Petition at pages 5-7. Although the opinion of the court of appeals ignores these restrictions, they provide effective protection against the "hazards" that concerned this Court in *Investment Company*

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[2]We note that respondent essentially ignores the rationale of the court of appeals in presenting this argument—further evidence, we submit, that the reasoning of the court below is untenable.

Institute v. *Camp*, 401 U.S. 617, 636-638 (1971). A bank operating within these restrictions would not be engaged in the process of issuing, underwriting, or distributing securities. See *id.* at 623-625.[3] As the Board has observed, the investment management activities that are described in its regulation are permissible both for bank holding companies and for banks under the Glass-Steagall Act (Pet. App. 61a-63a).

b. Moreover, there is no ground for respondent's assertion that the Bank Holding Company Act and the Glass-Steagall Act authorize bank holding companies to engage only in activities that are permissible for banks. The plain language of those statutes contradicts respondent's argument. Section 4(c)(8) of the Bank Holding Company Act permits bank holding companies to engage not only in banking activities, but also in activities that are "closely related" to banking. 12 U.S.C. 1843(c)(8). Section 4(a)(2) of the Act also states that bank holding companies may engage in the activities of "(A) * * * banking or of managing or controlling banks * * * and (B) those permitted under [Section 4(c)(8)]." 12

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[3]Contrary to respondent's assertion (Br. in Opp. 8, 16), this Court's decision in *Camp* did not forbid banks to manage all forms of investment companies. The Court in *Camp* was considering an investment fund equivalent to an *open-end* investment company, which is engaged in regular offerings and redemptions of its shares. See 401 U.S. at 625. The opinion in *Camp* does not suggest that a bank cannot operate a *closed-end* investment company within a body of regulations specifically designed to prevent abuses of the kind that concerned Congress when the Glass-Steagall Act was adopted. We also note that, in the present case, in contrast to *Camp*, the administrative agency has provided a detailed explication of its statutory interpretation and has demonstrated that it is compatible with the language and purpose of the Act. Compare 401 U.S. at 626-627 with Pet. App. 53a-64a, 65a-79a, 83a-87a. The Board's prior interpretations of the Glass-Steagall Act also have distinguished between closed-end and open-end investment companies. See 12 C.F.R. 218.101-102.

U.S.C. 1843(a)(2). The second phrase would be meaningless if "banking" activities alone were permissible under Section 4(c)(8). In addition, Section 4(c)(6) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(6), expressly authorizes bank holding companies to purchase common stock for their own account—an activity that is clearly impermissible for banks. And as we have noted (Pet. 16-17), Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly authorizes bank holding companies to purchase all or a part of the outstanding shares of an investment company.

The Glass-Steagall Act, like the Bank Holding Company Act, authorizes bank holding companies to engage in a broader range of business activities than banks. Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, prohibits bank holding companies from engaging "principally" in the issuance, sale, or distribution of securities. By using the qualifying term "principally," the statute clearly permits a secondary degree of involvement by bank holding companies in the distribution of securities. By contrast, Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, flatly prohibit bank participation in the issuance or distribution of securities. See *Board of Governors* v. *Agnew*, 329 U.S. 441, 447-448 (1947).

In sum, respondent's argument is without foundation because management of closed-end investment companies is permissible for banks and because bank holding companies may, in any event, engage in a substantially broader range of activities than their bank subsidiaries.

3. Respondent also argues that Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, does not define the scope of bank holding company securities activities, noting that Section 20 was not made applicable to bank holding companies until 1966 (Br. in Opp. 17-18).

However, Section 19(e) of the Glass-Steagall Act—the predecessor of Section 20—originally applied to bank holding companies and effectively barred them from controlling firms "engaged principally" in the distribution of securities (48 Stat. 188).[4] Section 19(e) was superseded in 1966 (80 Stat. 242-243), but the same legislation made Section 20 of the Glass-Steagall Act applicable to bank holding companies by revising the definition of bank "affiliate" and retained the "engaged principally" standard (80 Stat. 242). In sum, from the original enactment of the Glass-Steagall Act to the present, Congress has prescribed the same rule—bank holding companies are forbidden only to engage in those business activities that result in their becoming "engaged principally" in the issuance or distribution of securities. As discussed in the Petition, management of closed-end investment companies, within the limitations prescribed by the Board, does not infringe that standard.

4. Amicus Securities Industry Association suggests (Amicus Br. 6-7) that certain bills pending before Congress that would narrow the scope of Section 4(c)(8) diminish the importance of review by this Court in this case. However, similar legislation has often been considered by Congress but has not been enacted.[5] When Congress amended Section 4(c)(8) in 1970, it considered and expressly rejected a provision that would have barred bank holding companies from managing closed-

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[4]A bank holding company could not vote the shares of a bank subsidiary if it or a non-bank subsidiary was "engaged principally" in the investment banking business.

[5]Bills to modify Section 4(c)(8) have frequently been introduced in Congress but have failed to pass. See H.R. 11678, 93d Cong., 1st Sess. (1973); S. 2721, 94th Cong., 1st Sess. (1975); H.R. 13077, 94th Cong., 2d Sess. (1976); H.R. 11456 and S. 3087, 95th Cong., 2d Sess. (1978).

end investment companies (see Pet. 17-18). Congressional action on the proposed legislation cited by amicus is not imminent, and the recent actions of Congress in this area do not suggest that any active reexamination of the issues presented in this case is taking place.[6] Because the court of appeals has seriously misconstrued the statute that Congress actually enacted, and because congressional revision of the statute is not foreseeable at this time, review by this Court is warranted.

For these reasons and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

JANUARY 1980

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[6]H.R. 2747, 96th Cong., 1st Sess. (1979), which concerns investment advisory services of bank holding companies, has not been approved by the House Committee on Banking, Finance and Urban Affairs or any subcommittee.

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RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM OF THE AMERICAN BANKERS ASSOCIATION AS *AMICUS CURIAE*

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MEMORANDUM OF THE AMERICAN BANKERS ASSOCIATION AS *AMICUS CURIAE*

The American Bankers Association, with the consent of the parties, submits this memorandum *amicus curiae* in support of the petition for a writ of certiorari.

INTEREST OF THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association ("ABA") is the principal trade association of the commercial banking industry. The ABA represents approximately 14,300 banks of all sizes, or 94 percent of all commercial banks in the United States,

including banks in each of the fifty states and the District of Columbia. The ABA and its member banks have an obvious interest in this case, which presents an important question concerning the proper relationship between two major federal banking statutes.

ARGUMENT

1. *This case raises an important question of federal law that should be settled by this Court.* The court of appeals below incorrectly decided an issue of major importance to the banking industry, and in doing so it has injected substantial uncertainty into the administration of both the Glass-Steagall Act[1] and the Bank Holding Company Act, as amended, 12 U.S.C. §§ 1841 *et seq.*

The court of appeals in this case held that the Board of Governors of the Federal Reserve System exceeded its statutory authority by determining that sponsoring, organizing, or controlling (hereinafter collectively referred to as "sponsoring") a closed-end investment company[2] is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. § 1843(c)(8). This decision is of course a matter of direct concern to all bank holding companies that now sponsor closed-end investment companies or might in the future desire to do so. But

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[1] The Glass-Steagall Act, which was enacted as part of the Banking Act of 1933, 48 Stat. 162, is codified at various places throughout 12 U.S.C.

[2] "[A] closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. § 225.125(c). In contrast, an open-end investment company, or mutual fund, "is continuously engaged in the issuance of its shares and stands ready at any time to redeem the securities as to which it is the issuer." *Id.*

the opinion below also has much wider implications for the banking community at large. The apparent rationale of the court of appeals, that the "policies" of the Glass-Steagall Act bar national banks and bank holding companies alike from undertaking any of an inadequately delineated category of "securities activities," *e.g.*, Pet. App. A, p. 44a, is a matter of grave and general concern. This broad-brush approach to the carefully constructed statutory scheme governing the banking industry has needlessly cast a shadow over a broad spectrum of services that historically have constituted a significant part of the business of many banks of all sizes, including especially customary investment management and advisory services.

By substituting an appeal to the general "policies" of the Glass-Steagall Act in place of a close analysis of the statutory language, and by shunning altogether any analysis of the factors that traditionally have been considered relevant to a determination of whether activities are "closely related to banking," the court of appeals has withdrawn from the Board an indeterminate, but potentially substantial, portion of the regulatory authority that Congress intended the Board to exercise. The decision below thus leaves in its wake an unsettled regulatory climate, in which the Board cannot readily determine the scope of its legal authority and the banking industry consequently cannot be certain of its rights and responsibilities.

In short, this case presents an important question not only for bank holding companies but also for the Board and the banking industry generally. This Court should review the case in order to clarify the meaning and proper application of the Glass-Steagall and Bank Holding Company Acts and thereby dispel the confusion and uncertainty that have been engendered by the decision below.

2. *The judgment below is in error and should be reversed.* The decision of the court of appeals was wrong both in its analysis and in its result. The Glass-Steagall Act does not bar

a bank holding company from sponsoring a closed-end investment company, and the Board, in determining that such sponsorship is "closely related to banking," correctly weighed the factors pertinent under section 4(c)(8) of the Bank Holding Company Act. That determination therefore should have been sustained.

a. In the court below, the Investment Company Institute, respondent here, argued only that sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. §§ 24 (Seventh) and 378, barred bank holding companies from sponsoring closed-end investment companies. As the court of appeals correctly pointed out, however, those provisions do not even apply to bank holding companies. Indeed, the court of appeals itself did not rely upon any provision of the Glass-Steagall Act as prohibiting bank holding companies from sponsoring closed-end investment companies. Instead, the court rested its decision upon the sheer speculation that Congress, although it "may have been mistaken in its perception," Pet. App. A, p. 44a, nevertheless "probably believed," *id.* at 38a, that former section 19(e) of the Act, 48 Stat. 188, *repealed,* 80 Stat. 242-43, had barred such activity.

The court misread and misapplied the legislative history. There is absolutely nothing in that history that supports the proposition that Congress, either when it enacted section 19(e) or later, intended or understood that that statute related in any way to the sponsorship of closed-end investment companies. Even more significant than the court's misreading of the legislative history, however, is its fundamental analytical error in failing to "begin with the language of the statute itself." *Transamerica Mortgage Advisors* v. *Lewis,* 48 U.S.L.W. 4001, 4002 (Nov. 13, 1979). An analysis of the specific statutory text, which the court of appeals unaccountably failed to undertake, demonstrates that section 19(e) did not, and its present-day successor, section

20, 12 U.S.C. § 377,[3] does not, prohibit the sponsorship of closed-end investment companies.

Section 19(e) was not a prohibition on business activity at all. It simply imposed a restraint on the ability of a parent corporation to vote the shares of a banking subsidiary when the parent also had an interest in a company "formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities . . . ." *See Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243-44 (1978). Only in 1966, long after the enactment of the Bank Holding Company Act, was the Glass-Steagall Act amended to state an outright prohibition in this regard. At that time, section 19(e) was repealed and the coverage of section 20 expanded so as to bar the parent bank holding company from owning a controlling interest in a corporation engaged principally in activities of the kind formerly described in section 19(e). 80 Stat. 242-43.[4]

Section 20 of the Glass-Steagall Act, even as so amended, plainly does not preclude a bank holding company from sponsoring a closed-end investment company. Such an investment company performs solely fiduciary services: unlike an investment banking or brokerage firm, a closed-end investment company does not issue, distribute, or underwrite securities as a means of producing income; unlike a mutual

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[3] The court of appeals, "needless to say, ...intimate[d] no views as to the applicability to the present case of sections 20 and 32." Pet. App. A, p. 44a. Section 32 of the Glass-Steagall Act, 12 U.S.C. § 78, bars certain interlocking directorships and in fact appears to have no applicability here. Section 20, however, is the principal provision of the Glass-Steagall Act relating to bank holding companies.

[4] The coverage of section 20 was enlarged by an amendment to the definition of "affiliate" in section 2(b). See 80 Stat. 242.

fund, it is not engaged in the continuous issuance, sale, and distribution of its own shares. See note 2, *supra.*

Certainly a closed-end investment company is not "engaged principally in" issuing, underwriting, or distributing securities merely because, like any business corporation, it issues shares to acquire initial capital at the outset of business operations. *Cf. Board of Governors* v. *Agnew,* 329 U.S. 441, 446-49 (1947). Such an investment company is formed for the purpose of managing an investment portfolio as a fiduciary on behalf of its public owners, and it is "engaged principally in" that activity. In any event, the Board has permitted sponsorship only of closed-end investment companies that "are *not* primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f) (emphasis added). Accordingly, the Board's determination that such sponsorship is "closely related to banking" plainly does not contravene the prohibition of section 20.

b. Since the Glass-Steagall Act did not and does not prohibit a bank holding company from sponsoring a closed-end investment company, the Board had statutory authority to decide in the first instance whether such sponsorship was to be allowed under the Bank Holding Company Act. Section 4(a) of the Bank Holding Company Act generally bars bank holding companies from owning or controlling subsidiaries engaged in nonbanking activities. But in section 4(c)(8) of that Act, Congress has granted the Board broad legislative power to exempt from that prohibition activities that the Board determines to be "so closely related to banking . . . as to be a proper incident thereto."[5] In determining that the

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[5] The broad prohibition against ownership in section 4(a) of the Bank Holding Company Act meant that the narrower prohibition against the voting of shares in section 19(e) of the Glass-Steagall Act no longer served any substantial purpose. It was for this reason that section 19(e) was repealed. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). But by simultaneously enlarging the coverage of section 20 of

sponsorship of closed-end investment companies is "closely related to banking," and therefore permissible to bank holding companies, the Board acted well within its power under section 4(c)(8).

In making a determination under section 4(c)(8), the Board is required to examine the precise nature of the activities in question and the relationship or connection between those activities and banking activities. *See, e.g., Association of Bank Travel Bureaus* v. *Board of Governors,* 568 F.2d 549, 551-52 (7th Cir. 1978). The Board followed this approach here. The Board found that sponsoring, organizing, or controlling a closed-end investment company was similar or functionally related to the investment-advisory services traditionally performed by banks. See, *e.g.*, Pet. App. D, pp. 61a-63a. The determination that such sponsorship is "closely related to banking" was guided by the Board's thorough understanding of "matters relating to the banking industry structure and operations, areas in which the Board may be presumed to have expertise." *Alabama Ass'n of Insurance Agents* v. *Board of Governors,* 533 F.2d 224, 246 (5th Cir. 1976), *modified,* 558 F.2d 729 (1977), *cert. denied,* 435 U.S. 904 (1978). The Board's determination therefore was entitled to substantial deference and should have been sustained by the court of appeals. *See Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. at 254; *National Courier Ass'n* v. *Board of Governors,* 516 F.2d 1229, 1237 (D.C. Cir. 1975).

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the Glass-Steagall Act, Congress placed an implicit restriction on the Board's power under section 4(c)(8) of the Bank Holding Company Act: the Board may not authorize what section 20 prohibits. Conversely, however, the Board is free to consider the authorization of activities not barred by section 20.

CONCLUSION

The petition for a writ of certiorari should be granted.

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Respondent.

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BRIEF OF BANKAMERICA CORPORATION AND WESTERN BANCORPORATION, AND OF THE NEW YORK CLEARING HOUSE ASSOCIATION, AS *AMICI CURIAE* IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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This *amici curiae* brief is submitted in support of the petition for a writ of certiorari, which seeks review of a decision of the United States Court of Appeals for the District of Columbia Circuit. That decision is contained in the Appendices to the petition ("App.").

INTEREST OF *AMICI*

This brief is respectfully submitted by BankAmerica Corporation and Western Bancorporation ("*amici* bank holding companies") and The New York Clearing House Association ("Clearing House") with the consent of all parties to this case, pursuant to Rule 42(1) of the Rules of this Court. Both of the *amici* bank holding companies are subject to regulation by the Federal Reserve Board ("Board") and each has a non-bank subsidiary that provides various services, including the rendering of investment advice, to a registered closed-end investment company.[1] The Clearing House is an association of 12 major commercial banks, each of which is owned by a bank holding company subject to regulation by the Board.[2] The bank holding company parents of the Clearing House members (or their affiliates) either provide services to closed-end investment companies or may wish to provide such services in the future.

The decision below invalidated an eight-year-old Board regulation and interpretative ruling[3] that permits non-bank subsidiaries of bank holding companies to provide certain investment-related services to closed-end investment companies, pursuant to Section 4(c)(8) of the

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[1] A closed-end investment company typically does not issue shares after its initial organization and does not stand ready to redeem them. An open-end investment company (or mutual fund), on the other hand, is continuously issuing shares and stands ready to redeem those shares. 12 C.F.R. § 225.125(c); *see* App. at 84a.

[2] The Clearing House's members are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, National Bank of North America, and European American Bank & Trust Company.

[3] 12 C.F.R. § 225.4(a)(5)(ii), *as interpreted in* 12 C.F.R. § 225.125 (1978) (App. 80a-87a).

Bank Holding Company Act, 12 U.S.C. § 1843(c)(8). The decision will have an immediate and adverse impact upon bank holding companies that render such services to closed-end investment companies. Moreover, it raises substantial doubts as to what other investment-related services the Board may permit bank holding companies and their non-bank subsidiaries to perform pursuant to Section 4(c)(8). *Amici* thus have a special interest in and perspective regarding the decision that is shared by neither of the parties.

REASONS FOR GRANTING THE WRIT

This case presents important questions of federal law regarding the interpretation of the Bank Holding Company Act[4] and the Glass-Steagall Act,[5] the regulatory authority of the Board under those statutes, and the appropriate roles of the commercial banking and investment banking communities. Review is required because the court of appeals wrongly decided these questions, with serious consequences. In particular, the decision below: confuses the relationship between the Bank Holding Company Act and the Glass-Steagall Act; unduly restricts the statutory authority of the Board to determine what activities are "closely related to banking" for purposes of Section 4(c)(8), and thus permitted to bank holding companies; limits competition in the furnishing of investment-related services; raises serious doubts as to what other services bank holding companies can offer; undercuts the justified reliance that bank holding companies have heretofore placed—and should be able to continue to place—on the Board's determinations under

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[4] 12 U.S.C. §§ 1841, *et seq.*; *see* App. at 90a-91a.

[5] Act of June 16, 1933, ch. 89, 48 Stat. 162. The provisions of the Glass-Steagall Act at issue here, Sections 16, 20, 21, and 32, respectively, are codified at 12 U.S.C. §§ 24 (Seventh), 377, 378, and 78; *see* App. at 88a-90a.

Section 4(c)(8) of the Bank Holding Company Act; and creates confusion with respect to the Glass-Steagall Act's regulatory differentiation between the roles of commercial bankers and investment bankers.

1. Section 4(c)(8) broadly authorizes the Board to permit bank holding companies and their non-bank subsidiaries to engage in activities which the Board "after due notice and opportunity for hearing has determined . . . to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." Acting pursuant to this broad authority, the Board in 1972 adopted the instant regulation and interpretative ruling, which in general permit bank holding companies and their non-bank subsidiaries to organize, manage, or otherwise serve as investment advisers to closed-end investment companies.[6] The Board's action imposed specific restrictions designed to assure that the authorized activities of bank holding companies remain well within the ambit of lawfulness under the Glass-Steagall Act, which in effect prohibits a bank holding company or its affiliates from being engaged "principally" in the "issue, flotation, underwriting, public sale, or distribution" of securities. 12 C.F.R. §§ 225.125(d)-(i). The Department of Justice contemporaneously lauded this action as "pro-competitive" (App. 7a n. 11).

The court of appeals did not quarrel with the Board's conclusion that the various investment services at issue were "closely related to banking." The court found no provision of the Glass-Steagall Act to have been violated,

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[6] Specifically, the Board ruled that:

> "a bank holding company may exercise all functions that are permitted to be exercised by an 'investment adviser' under the Investment Company Act of 1940, except to the extent limited by the Glass-Steagall Act provisions, as described, in part, hereinafter." 12 C.F.R. § 225.125(d) (App. 84a-85a).

and specifically rejected the investment company industry's argument that Sections 16 and 21 of the Glass-Steagall Act forbade the Board's action (App. 14a-23a). Nevertheless, the court concluded that the Board's regulation contravened the "policies" of the Glass-Steagall Act, which "carry forward and inform the meaning of" the Bank Holding Company Act, to limit what the Board may authorize under Section 4(c)(8), even though neither the Glass-Steagall Act nor Section 4(c)(8) independently contain such limits (App. 23a-25a).

2. Not only is the court of appeals' approach logically inconsistent, but its decision is wrong as a matter of statutory construction and sound banking policy. Contrary to the plain language and legislative history of Section 4(c)(8),[7] the court of appeals' decision would greatly extend the reach of Glass-Steagall by premising a violation of Section 4(c)(8) solely upon Glass-Steagall "policies" even where—as here—the Glass-Steagall Act itself has not been violated and the purportedly applicable policies are nowhere explicitly defined. By thus extending the prohibitions of Glass-Steagall far beyond the limits that Congress itself carefully set for the legislation, *see Board of Governors* v. *Agnew*, 329 U.S. 441, 447-48

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[7] There is nothing to support the court of appeals' conclusion either in the plain language or legislative history of the predecessor to Section 4(c)(8) passed in 1956, or in the plain language or legislative history of Section 4(c)(8) itself. What the legislative history of the 1970 amendment that produced Section 4(c)(8) does show is that the Conference Committee deleted a proposed specific prohibition of the operation by bank holding companies of closed-end investment companies, *see* H.R. Rep. No. 1747, 91st Cong., 2d Sess. 13-14 (1970); the court of appeals conceded that this deletion seemingly constituted "a specific endorsement of the Board's action challenged in this case" (App. 38a). The legislative history also demonstrates that the 1970 amendment was intended *not* to change existing law in this area, *see* 116 CONG. REC. 42430 (1970) (colloquy between Senators Sparkman and Williams; the Board's action here, of course, was carefully designed to conform to existing law, *i.e.*, the Glass-Steagall Act.

(1947), the court of appeals has engaged in judicial legislation and improperly limited the power of the Board.[8]

3. The court of appeals' decision effectively alters the nature of the Board's role—and that of reviewing courts —under Section 4(c)(8). As amended in 1970, Section 4(c)(8) was intended to allow the Board substantial latitude in determining whether specific activities are "closely related to banking." The court of appeals thus should have deferred to the Board's construction of its statutory mandate, *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978), particularly since the Board specifically tailored its determination to accommodate the requirements of the Glass-Steagall Act. However, instead of deferring and, indeed, without questioning the Board's determination that the investment services at issue here are "closely related to banking," the court ruled as a matter of law that the Board had no statutory authority to make that determination. The court of appeals thus effectively withdrew a portion of the authority that Congress granted the Board to make "closely related" determinations under Section 4(c)(8), and it substituted for the statutory criterion a vague new securities-related standard with respect to which reviewing courts may always second-guess the Board. The court of appeals thereby interpreted the scope of the Board's authority in a manner inconsistent with the decision of several courts of appeals that recognize the latitude to be given Section 4(c)(8) determinations.[9]

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[8] *See Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 535-58 (1978).

[9] *Association of Bank Travel Bureaus* v. *Board of Governors*, 568 F.2d 549, 552 (7th Cir. 1978); *Alabama Ass'n of Ins. Agents* v. *Board of Governors*, 533 F.2d 224, 235 (5th Cir. 1976), *modified*, 558 F.2d 729 (5th Cir. 1977), *cert. denied*, 435 U.S. 904 (1978); *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1237 (D.C. Cir. 1975).

4. Moreover, the standard adopted by the court of appeals confounds the distinctions between commercial banking and investment banking that Congress painstakingly drew in the Glass-Steagall Act. In the core provisions of that Act—Sections 5, 16, and 21, respectively—Congress prohibited commercial banking institutions from dealing in securities for their own account or underwriting issues of securities, in order to exclude such institutions from the distribution and market-making functions traditionally performed by investment bankers. The court of appeals' opinion, however, may be read to suggest that commercial banking institutions are prohibited from engaging in any "securities activities," whatever the court considered those to be. Such a theory has nothing in common with either the language or the purpose of the Glass-Steagall Act, and—unless reviewed by this Court—can serve only to confuse the functional delineations between commercial and investment banking firms that have heretofore been clear.

5. In sum, the court of appeals' decision will not only restrict the amount and quality of investment-advisory services available to consumers of such services, but it will also expand the reach of the Glass-Steagall Act beyond the limits set by Congress, and thoroughly confuse the provisions of two banking statutes that Congress designed to perform very different functions. The decision thus has created serious uncertainty concerning what investment-related services *amici* and others can perform pursuant to the Bank Holding Company Act and what activities the Board may authorize for the future. The decision below was wrong, and, if left unreviewed, will have significant and pernicious effects upon the market for investment services and upon banking regulation in this country.

CONCLUSION

For the reasons stated above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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The Securities Industry Association, with the consent of the parties, submits this brief *amicus curiae* in opposition to the petition for a writ of certiorari.

INTEREST OF THE AMICUS

The Securities Industry Association ("SIA") is a national trade association representing approximately

500 organizations responsible for over 90 percent of the securities brokerage and investment banking business of the nation. Its membership is a cross-section of the diverse facets of the securities business and encompasses members of the national securities exchanges as well as firms which are not members of such exchanges. The business of its members includes retail and institutional brokerage, over-the-counter market-making, underwriting and other investment banking activities. Many SIA members sponsor open- and closed-end investment companies, which permit the investing public to pool investment capital and obtain the advantages of a broader portfolio of investments than otherwise would be available to most individual investors. The SIA and its members have a clear interest in the subject matter of this proceeding, which is whether the banking industry should be permitted to expand into the securities business by sponsoring closed-end investment companies.

REASONS FOR DENYING THE WRIT

1. *The narrow legal issue decided below, namely, that bank holding companies should not organize, sponsor and control closed-end investment companies, has little impact on current activities of bank holding companies.*

Between 1972, when Regulation Y of the Board challenged herein first became effective, and 1977, when the Investment Company Institute filed its petition for reconsideration with the Board, apparently only four out of the over 2,200 registered bank holding companies undertook to sponsor closed-end investment companies. Moreover, based on the statistics in the Petition for Certiorari, the total net assets of the ten closed-end investment companies presently man-

aged by any kind of banking organization amount to approximately only one percent of the total assets of the registered investment companies in the United States.[1] Thus, the immediate impact of the narrow holding below is slight. In an attempt to breathe significance into the decision in terms of present day banking practices, Petitioner and the other *Amici* address an issue that was neither raised nor decided below, namely, whether bank holding companies can provide investment advisory services to investment companies. As stated by the Court of Appeals below:

> . . . we do not reach, and are not to be taken as expressing any view on, the question of whether bank holding companies and their non-bank subsidiaries may, either under the present regulation or one more narrowly drawn, render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies.[2]

2. *This Court already has addressed the controlling Congressional policy involved: that the commercial banking industry should not be permitted to sponsor or operate investment funds marketed to the general public.*

Investment Company Institute v. *Camp*[3] struck down an attempt by the Comptroller of the Currency to permit national banks to operate open-end investment funds. In holding such activity violated Sections 16 and 21 of the Glass-Steagall Act,[4] this Court de-

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[1] *See* Petition for Writ of Certiorari ("Pet.") at 11 and *SEC Final Report on Bank Securities Activities* at 148 (1977).

[2] Pet., App. A at 48a-49a.

[3] 401 U.S. 617 (1971).

[4] 12 U.S.C. §§ 24 (Seventh) and 378.

scribed the concerns which led Congress to insist that commercial banking be divorced completely from investment banking. Among the principal concerns were (A) impairment of public confidence in the bank if the securities affiliate fares badly since the bank and the affiliate become closely associated in the public mind; (B) pressure on the bank to make its credit facilities and possibly even unsound loans more readily available to companies in whose securities the affiliate has invested or otherwise become involved; (C) possible risk that bank depositors would suffer losses on the investments they purchased in reliance on the relationship between the bank and its securities affiliate; (D) danger that the bank would be tempted to make customer loans more liberally for purposes of facilitating the purchase of its affiliates' securities; and (E) conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice.[5]

> In sum, Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system.[6]

While in *Camp* the bank operated the fund itself, the concerns expressed above apply with equal force to sponsorship of investment funds by a bank holding company. Thus, the Board properly concluded in Reg-

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[5] 401 U.S. at 629-633.

[6] *Id.* at 634.

ulation Y that the Glass-Steagall Act, as interpreted in *Camp,* prohibits a bank holding company from sponsoring an open-end investment company.[7] The Board went on, however, in that portion of Regulation Y challenged below, to draw a distinction between open- and closed-end funds that has no substance in terms of the concerns of Congress set forth above.

Although open- and closed-end investment companies differ in certain aspects of their operations, both are formed for the purpose of "buying and selling securities acquired purely for investment or speculative purposes."[8] In both cases, the bank holding company "would necessarily put its reputation and facilities squarely behind that fund and the investment opportunity that fund offered" and poor performance of the fund "could bring about a perhaps unjustified loss of public confidence" in its affiliated bank.[9] The fact that a closed-end fund does not stand ready to redeem its shares and typically sells its stock to the public less frequently than an open-end fund does not materially reduce the financial risks inherent in the fund's operation or the loss of public confidence that would attend its failure. Moreover, the other concerns underlying the Glass-Steagall Act that are reiterated above from *Camp* regarding banking industry sponsorship of investment funds apply with equal force to closed-end and to open-end funds. Lastly, as the Court below found, bank holding company sponsorship and control of closed-end funds poses the risk of centralization of economic power regarding which, the Court of Appeals

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[7] *See* 12 C.F.R. § 225.125(f) [Pet., App. F at 85a].

[8] 401 U.S. at 635.

[9] *Id.* at 637.

noted, Congress was particularly concerned when it enacted the 1970 Amendments to the Bank Holding Company Act.[10] It is simply not realistic, therefore, to assume, as the Board does, that Congress intended emphatically to prohibit bank holding companies from sponsoring one kind of investment fund but not the other. At the very least, such a dubious distinction should not be drawn without a much clearer and more specific expression of Congressional intent than that relied upon by the Board.

3. *The issue presented is one of several issues involving securities and other non-banking activities of bank holding companies that are currently under active consideration by Congress.*

The Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs recently conducted extensive hearings on three bills, H.R. 1539 (which would permit banks to underwrite and deal in revenue bonds) and H.R. 2747 and H.R. 2856 (which would limit substantially the non-banking activities of bank holding companies). H.R. 2747, styled the "Bank Holding Company Amendments of 1979," in addition to codifying the decision of this Court in *Camp* and that of the Court of Appeals below regarding sponsorship of publicly marketed investment funds, would also preclude a bank holding company from being affiliated with any firm that acts as an investment adviser to such funds. H.R. 2856 would restrict more severely the activities in which bank holding companies may engage to those which are a

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[10] Pet., App. A at 46a.

"proper and necessary incident" to the business of banking.[11]

During the hearings, the Chairman of the Securities and Exchange Commission noted, *inter alia,* that the whole structure of the securities industry was undergoing very substantial change since elimination in 1975 of fixed brokerage commissions and the effort to develop a national market system.[12] He also observed that banks may achieve competitive advantages over securities firms because there are significant differences in the laws and regulations governing them from those governing securities firms.[13] The Chairman concluded:

> The Commission shares the concerns addressed in H.R. 2747 and H.R. 2856 with respect to the proper role of banks in securities activities. . . . [T]he bills now before you raise important questions with respect to the health of our capital markets, and the continued validity of the traditional distinction between commercial and investment banking. We favor competition. Indeed, we are charged by our statutes to promote it. But these bills raise questions about the dangers of excessive concentration of economic power, about the financial service needs of the public and private sectors, about potential conflicts of interest

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[11] A similar bill currently pending in the Senate, S. 39, would impose comparable and equally strict limitations on bank holding companies.

[12] Statement of Harold M. Williams, Chairman of the Securities and Exchange Commission, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, regarding H.R. 1539, H.R. 2747 and H.R. 2856, 96th Cong., 1st Sess., Oct. 17, 1979, at 5.

[13] *Id.* at 14-17.

> and about unequal regulation. These are important, broad and complex issues which need to be addressed by the Congress.[14]

Acceptance of the Board's tenuous reading of its authority under the Bank Holding Company Act would give it a charter to depart substantially from the clear policy expressed by Congress and thereby alter the existing delicate competitive balance between the banking and securities industries at a time when Congress is actively reexamining the broader issues raised by the banking industry's multipronged efforts to reenter the securities business. Because of the many complex and interrelated factors to be weighed, it would be more appropriate for Congress, rather than the Board, to provide the necessary policy guidance in this area, as that body has in the past.

4. *The decision below is clearly correct.*

Section 4(c)(8) of the Bank Holding Company Act is a narrowly drawn exception to the general thrust of that Act, which is to *restrict* the non-banking activities of bank holding companies. The Board is authorized to permit bank holding companies to engage only in those activities it finds "to be so closely related to banking . . . as to be a proper incident thereto." [15] Moreover, as Judge McGowan, speaking for a unanimous panel, carefully traced, the legislative history of the Bank Holding Company Act shows that it was "a loophole-closing law designed to further the Glass-Steagall Act's overarching policy . . . of divorcing investment from commercial banking." [16]

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[14] *Id.* at 13, 17-18.

[15] 12 U.S.C. § 1843(c)(8) [Pet., App. G at 91a].

[16] Pet., App. A at 30a.

The Board's expansive reading of Section 4(c)(8) as authorizing it to permit bank holding companies to organize, sponsor and control closed-end investment companies is totally at odds with this purpose of the Bank Holding Company Act. It is equally at odds with the plain meaning of the language of Section 4(c)(8), which cannot reasonably be read as suggesting that securities activities expressly forbidden to banks can nevertheless "be so closely related to banking . . . as to be a proper incident thereto."

In the final analysis, the opinion properly concludes, as this Court recognized in *Camp,* that Congress did not want the banking industry involved in sponsoring investment funds marketed to the public. This left the Court of Appeals with no reasonable basis on which to uphold the Board's action to the contrary.

CONCLUSION

The petition for a writ of certiorari should be denied.

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In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-49a) is reported at 606 F.2d 1004.

JURISDICTION

The judgment of the court of appeals (Pet. App. 50a) was entered on March 30, 1979. A petition for rehearing was denied on July 16, 1979 (Pet. App.

51a-52a). On October 11, 1979, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including December 13, 1979. The petition was filed on that date and was granted on February 19, 1980. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, under Section 4(c)(8) of the Bank Holding Company Act of 1956, the Federal Reserve Board may authorize bank holding companies to organize and manage closed-end investment companies to the extent permitted by the Glass-Steagall Act.

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are set forth in the Appendix attached to this brief.

STATEMENT

1. On February 1, 1972, the Federal Reserve Board (the "Board") promulgated a regulation which provides that serving as an investment adviser to a registered investment company[1] is an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8), and is therefore

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[1] The definition of "investment company" contained in the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.*, includes companies engaged primarily in the business of investing in securities. See 15 U.S.C. 80a-3(a). Certain investment companies are required to register with the Securities and Exchange Commission. 15 U.S.C. 80a-7, 80a-8.

permissible for a bank holding company.[2] 12 C.F.R. 225.4(a)(5)(ii) (Pet. App. 81a). An interpretive ruling accompanying the regulation, 12 C.F.R. 225.125 (Pet. App. 83a-87a), set forth the limitations that the Board concluded should be imposed on bank holding companies serving as investment advisers[3] to imple-

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[2] A "bank holding company" is defined in Section 2(a)(1) of the Bank Holding Company Act, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [*inter alia*] the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *."

The Board's determination that an activity is "closely related to banking" and thus is permissible for bank holding companies does not, by itself, authorize any particular bank holding company to engage in that activity. A bank holding company must apply to the Board for permission to engage in the activity. The Board is then required to determine whether the public benefits reasonably expected to result from the performance of the activity by the particular holding company outweigh any possible adverse effects. 12 U.S.C. 1843(c)(8). The Board also has authority to supervise holding companies so engaged to prevent the violation of federal laws or regulations and to ensure sound banking practices. 12 U.S.C. 1818(b)(1), (3); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3646.

[3] The Board's regulation authorizing bank holding companies to serve as investment advisers increased the types of fiduciary services that holding companies might provide. The Board had previously authorized fiduciary services such as advising real estate investment trusts, providing portfolio investment advice, furnishing general economic information, and providing financial advice to state and local governments. 12 C.F.R. 225.4(a)(5)(i)-(v).

ment the provisions of the Glass-Steagall Act.[4] In light of this Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), the Board determined that certain activities ordinarily performed by investment advisers on behalf of investment companies are permissible for bank holding companies, while others are prohibited.[5]

The Board's interpretive ruling draws a distinction between open-end and closed-end investment companies. The ruling forbids a bank holding company serving as an investment adviser to organize or control an open-end investment company. An open-end investment company typically stands ready to sell and redeem its shares at any time and thus is continuously engaged in the process of issuing securities. 12 C.F.R. 225.125(f), (c).[6] Closed-end investment

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[4] The Banking Act of 1933, ch. 89, 48 Stat. 162, contains several provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks, such as bank holding companies and companies under common control with banks, in specified securities activities. See Section 16, 12 U.S.C. 24 Seventh; Section 20, 12 U.S.C. 377; and Section 21, 12 U.S.C. 378.

[5] In its interpretive ruling, the Board acknowledged that the Glass-Steagall Act was not modified by the Bank Holding Company Act Amendments of 1970 and that, accordingly, the Glass-Steagall Act's restrictions on securities activities of bank affiliates apply to bank holding companies serving as investment advisers. 12 C.F.R. 225.125(b), (e), (f).

[6] Open-end investment companies are known as "mutual funds." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625 n.11. Under the Board's interpretive ruling, a bank holding company may only provide investment advice to (as distinguished from organizing or controlling) an open-end investment company. 12 C.F.R. 225.125(c), (f).

companies, in contrast, do not stand ready to redeem their shares and do not issue their shares after initial organization except on infrequent occasions. In light of this difference, the Board's interpretive ruling permits a bank holding company to organize and control a closed-end investment company,[7] with the caveat that such management activities are permissible only if the investment company is not primarily or frequently engaged in the issuance of securities. 12 C.F.R. 225.125(f), (c). In addition, the Board's interpretive ruling expressly forbids a bank holding company to engage directly or indirectly in the sale or distribution of any securities issued by any investment company. 12 C.F.R. 225.125(h).

The interpretive ruling also imposes restrictions designed to eliminate potential conflicts of interest and unsound banking practices of the types discussed by this Court in *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630-634, 636-639. A bank holding company and its subsidiaries are forbidden to purchase for their own account securities of any advisee investment company or to purchase such securities for any other person in a discretionary fiduciary capacity. A bank holding company and its

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[7] This control is subject to the provisions of the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.* Under Section 10(a) of that Act, 40% of the directors of the client company must be independent of the investment adviser. 15 U.S.C. 80a-10(a). These independent outside directors are empowered, under Section 15 of the Act, to terminate the advisory contract with the investment adviser. 15 U.S.C. 80a-15(a), (c). See *Burks* v. *Lasker*, 441 U.S. 471, 482-483 (1979).

subsidiaries are also forbidden to extend credit to any such investment company or to accept its securities as collateral except in limited circumstances. 12 C.F.R. 225.125(g). To insure its complete separation from investment banking, every bank holding company is forbidden to distribute prospectuses or sales literature concerning its advisee investment company, and such materials may not be made available to the public at any office in the bank holding company system. Officers of subsidiary banks may not express opinions concerning the purchase of shares of an advisee investment company, and the names of bank customers may not be furnished to such investment company or its representatives. The Board's interpretive ruling also strictly limits the making of deposits on behalf of an advisee investment company in any subsidiary bank of an adviser holding company. 12 C.F.R. 225.125(h), (i).

2. In December 1973, respondent Investment Company Institute ("ICI"), a trade association of open-end investment companies, petitioned the Board to rescind its regulation and interpretive ruling. Respondent claimed that the regulation authorized activities violative of Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 12 U.S.C. 378, and for that reason could not lawfully be adopted by the Board under the Bank Holding Company Act. In March 1974 the Board denied respondent's petition (Pet. App. 53a-64a). With respect to Section 16 of the Glass-Steagall Act, which applies only to banks, the Board explained that its regulation and

interpretive ruling authorize activities only for bank holding companies and their non-bank subsidiaries rather than for banks (Pet. App. 60a-61a). Similarly, the Board pointed out that Section 21 of the Glass-Steagall Act does not apply to the activities of institutions such as bank holding companies that do not receive deposits (Pet. App. 54a-56a).

The Board further explained that the investment advisory activities authorized by its regulation are closely connected to conventional banking functions: "investment advisory services * * * ha[ve] been a traditional banking function as long as there have been banks" (Pet. App. 57a). The Board added that "banks historically have furnished investment advice to trust accounts; these include testamentary trusts, *inter vivos* trusts, executorships and guardianships, managing agency accounts and pension and profit sharing trusts. In all of these traditional trust activities, banks place orders with independent broker-dealer firms to buy and sell stocks and other securities" (Pet. App. 62a; see also A. 20).

Respondent filed a second petition for rescission of the Board's regulation and interpretive ruling after judicial review of the Board's first order was denied on jurisdictional grounds.[8] In August 1977, the Board denied respondent's petition and reaffirmed its previous determination (Pet. App. 65a-79a).

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[8] *Investment Co. Institute* v. *Board of Governors of the Federal Reserve System*, 398 F. Supp. 725 (D.D.C. 1975), aff'd, 551 F.2d 1270 (D.C. Cir. 1977).

3. Respondent sought review of the Board's denial of its petition for rescission in the United States Court of Appeals for the District of Columbia Circuit. The court of appeals expressly rejected respondent's contention that organization and control of a closed-end investment company by a bank holding company violate Sections 16 and 21 of the Glass-Steagall Act (Pet. App. 14a-23a). Nonetheless, even though neither respondent nor any other party had directly raised the issue in any forum, the court set aside the Board's regulation and interpretive ruling on the theory that the challenged regulation and ruling exceeded the Board's authority under Section 4 (c)(8) of the Bank Holding Company Act (Pet. App. 23a-46a).

The court found "virtually no guidance" on this question in the legislative history of the Bank Holding Company Act as originally enacted in 1956 (Pet. App. 30a). It concluded, however, that the Act's grant of authority to the Board to authorize bank holding companies to engage in "financial" and "fiduciary" activities "closely related" to the business of banking (70 Stat. 137) could not be construed to permit the management of closed-end investment companies because of the generally understood policy of the Glass-Steagall Act to divorce "investment from commercial banking" (Pet. App. 30a). The court also concluded that Congress, in amending the Bank Holding Company Act in 1970, believed that the Glass-Steagall Act prohibited bank holding companies from managing closed-end investment companies. The

court reached that conclusion even though it previously had rejected respondent's contention that the Glass-Steagall Act in fact had such a preclusive effect (Pet. App. 43a-44a).[9]

SUMMARY OF ARGUMENT

Resolution of the question presented in this case requires a two-fold determination. First, does the Glass-Steagall Act forbid a bank holding company to organize and manage a closed-end investment company? Second, if not, does the Bank Holding Company Act forbid a bank holding company to serve in that capacity?

I.

A. The court of appeals correctly rejected respondent's challenge to the Board's regulation and interpretive ruling under the Glass-Steagall Act. As the court of appeals and the Board both recognized, the Glass-Steagall Act prescribes different rules for banks and for bank "affiliates" (including bank holding companies and companies under common control with banks). Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, prescribe standards governing the securities activities of banks. The legal standard applicable to bank "affiliates," how-

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[9] After handing down its opinion, the court issued an order amending the opinion by adding a sentence stating that the court was withholding judgment on the question whether bank holding companies and their nonbank subsidiaries may "render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies" (Pet. App. 48a-49a).

ever, is the standard contained in Section 20 of the Glass-Steagall Act, 12 U.S.C. 377. Section 20 provides that a bank affiliate may not engage "principally" in the issuance or underwriting of securities. Section 20 thus prescribes a qualified prohibition. *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-448 (1947). The statute forbids a bank affiliate to engage principally or predominantly in the issuance or underwriting of securities, but does not forbid an incidental or remote involvement.

B. Under the Board's regulation and interpretive ruling, a bank holding company is authorized to "control" a closed-end investment company. Even if such a closed-end company is deemed a bank "affiliate" by reason of that control (see 12 U.S.C. 221a(b)(2)), the activities of a closed-end investment company do not violate the requirements of Section 20 of the Glass-Steagall Act. By definition, a closed-end investment company managed by a bank holding company pursuant to the Board's regulation and ruling does not engage "principally" in the issuance or distribution of securities.

The principal activity of a closed-end investment company is to invest and reinvest the assets that have been committed to the enterprise. A closed-end investment company issues its own shares only at the time of original organization and at infrequent intervals thereafter. It is identical in this respect with other corporations that "go public" by issuing stock. Unlike open-end investment companies, which con-

tinuously issue new shares to offset share redemptions, a closed-end company does not seek to replenish or increase its capital base after organization. For this reason, the Board consistently has distinguished between closed- and open-end investment companies in applying the restrictions of the Glass-Steagall Act. In addition, the Board's regulation and ruling expressly provide that bank holding companies may manage only closed-end investment companies that do not issue or distribute shares primarily or frequently. Thus, the activities of such companies cannot violate Section 20 of the Glass-Steagall Act. *Board of Governors of the Federal Reserve System* v. *Agnew, supra.*

C. A bank holding company managing a closed-end investment company is a bank "affiliate" subject to the restrictions of Section 20 of the Glass-Steagall Act. See 12 U.S.C. 221a(b)(4). Thus, it is necessary to ensure that such a bank holding company does not engage "principally" in the issuance or distribution of securities. The Board's regulation and ruling foreclose that possibility.

In organizing and managing an investment company, a bank holding company does not itself issue securities. Moreover, the Board's regulation and ruling provide that a bank holding company may organize and manage only a closed-end investment company, which issues securities only at the time of its initial organization or on infrequent occasions thereafter. The regulation and ruling also provide that a bank holding company serving as an investment

adviser may not "directly or indirectly" sell or distribute the shares of its advisee investment company. That underwriting task must be performed solely by an investment banker unaffiliated with the holding company. Likewise, a bank holding company and its subsidiaries are forbidden to distribute prospectuses or sales literature relating to the shares of its advisee investment company. Thus, even with respect to closed-end investment companies that issue securities only infrequently, the Board's regulation and ruling effectively divorce bank holding companies from the process by which securities are distributed. That segregation of the underwriting business from the business of managing investments further assures that the services performed by bank holding companies are "principally" fiduciary services, not investment banking services.

D. The Board's regulation and interpretive ruling also prescribe safeguards to prevent conflicts of interest and unsound banking practices of the kind that concerned Congress when the Glass-Steagall Act was enacted. The overriding purpose of the Glass-Steagall Act was to safeguard banks from losses resulting from participation in the speculative business of securities trading and investment banking. *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629-630 (1971). The Board's regulation and ruling serve that purpose. A bank holding company and its bank and non-bank subsidiaries are strictly forbidden to purchase interests in or lend money to an advisee investment company. 12 C.F.R. 225.125(g).

The Board's regulation and ruling also protect against the "more subtle hazards" (401 U.S. at 630) resulting from participation in investment banking. Under the Board's regulation and ruling, a bank holding company and its subsidiaries may not engage in the competitive business of selling investments. Promotional literature concerning the shares of investment company advisees may not be distributed at offices in the holding company system and the names of bank customers may not be furnished to persons distributing such shares. 12 C.F.R. 225.125 (h). Moreover, to avoid potential injury to a holding company's reputation that could result from the poor performance of its advisee's investment portfolio, the Board has prohibited a bank holding company from managing an investment company with a name similar to that of the holding company or any subsidiary bank. 12 C.F.R. 225.125(f). Finally, to prevent conflicts of interest, the Board also has forbidden a bank holding company and its subsidiaries to exercise fiduciary powers to purchase securities of an advisee investment company, and employees of subsidiary banks may not express opinions on the investment merits of the shares of an advisee investment company. 12 C.F.R. 225.125(g), (h).

These prophylactic rules assure that the remedial purposes of the Glass-Steagall Act are achieved in fact. The Board's determination that these safeguards suffice to implement the statutory objective and to protect the public interest is entitled to substantial judicial deference. *Ford Motor Credit Co.*

v. *Milhollin*, No. 78-1487 (Feb. 20, 1980); *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 450 (Frankfurter and Rutledge, JJ., concurring).

II.

A. Having rejected respondent's contention that organization and management of a closed-end investment company by a bank holding company infringe the Glass-Steagall Act, the court of appeals should have upheld the Board's regulation and interpretive ruling. Instead, however, the court of appeals concluded that Congress intended to foreclose such activities under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). That conclusion disagrees with the plain meaning of Section 4(c)(8).

Section 4(c)(8) authorizes the Board to permit bank holding companies to engage in non-banking activities that are "closely related" to banking. The statute does not, on its face, prohibit any particular activity. Instead, it delegates to the Board the discretionary task of drawing the line between permissible and impermissible activities. Nothing on the face of the statute suggests that the Board is powerless to authorize a bank holding company to organize and manage a closed-end investment company.

The structure of the Bank Holding Company Act reinforces this interpretation. Under Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), bank holding companies are expressly authorized to acquire any or all of the shares of an investment company. They may also manage, control, and provide services to a

subsidiary investment company. In light of Congress' express authorization to bank holding companies to own, manage, and control an investment company subsidiary, it is untenable to assert that Congress believed that rendering management services to a closed-end investment company was forbidden under the flexible standard of Section 4(c)(8).

B. The legislative history of Section 4(c)(8) shows that Congress intended to vest the Board with discretion to authorize non-banking activities closely related to banking. It also shows that Congress contemplated that the Glass-Steagall Act alone would serve as the touchstone to determine whether a particular activity results in an undue connection between commercial and investment banking. Congress did not intend to fashion a new standard of "securities-relatedness" under Section 4(c)(8).

The legislative history does not suggest that Congress believed that Section 4(c)(8) would foreclose bank holding companies from managing closed-end investment companies. To the contrary, the Senate Committee Report on the 1970 amendments to the Bank Holding Company Act shows that Congress believed that the Board could authorize bank holding company management even of open-end investment companies to the extent permitted by the Glass-Steagall Act. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 15 (1970).

C. Neither respondent nor the court of appeals questioned the Board's factual determination that

management of a closed-end investment company is an activity "closely related" to banking. In light of the explicit provision contained in Section 4(c)(7) of the Bank Holding Company Act, which authorizes bank holding companies to acquire and manage their own investment company subsidiaries, such a contention would be wholly meritless. Nothing in the record in this case suggests that the Board's determination that such investment management activities are closely related to banking is arbitrary or capricious. Banks have traditionally organized and administered large collective investment funds such as common trust funds and pooled employee benefit funds through their trust departments. In addition, available statistics demonstrate that commercial banks and trust companies have for many years sponsored, organized, and managed closed-end investment companies.

Because Congress intended to delegate to the Board the decision whether a particular activity is "closely related" to banking (S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955)), and because the Board's judgment on this essentially factual question is entitled to judicial deference, the Board's determination under Section 4(c)(8) that organization and management of a closed-end investment company is an appropriate fiduciary function for a bank holding company should be upheld.

ARGUMENT

ORGANIZATION AND MANAGEMENT OF A CLOSED-END INVESTMENT COMPANY ARE ACTIVITIES PERMISSIBLE FOR A BANK HOLDING COMPANY UNDER SECTION 20 OF THE GLASS-STEAGALL ACT AND SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT

By enacting Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), Congress determined that bank holding companies may engage in certain business activities distinct from banking, provided that the Federal Reserve Board finds that those activities are so closely related to banking as to be a proper incident thereto. The statute does not specify any activities that the Board must approve as closely related to banking, and it does not forbid any activities. However, Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, limits the activities of bank affiliates, including bank holding companies and companies under common control with banks, and provides that such affiliates shall not engage "principally" in the issuance, flotation, underwriting, public sale or distribution of securities. Thus, Section 20 places an outer limit on the scope of activities that may be authorized under Section 4(c)(8) of the Bank Holding Company Act.

In authorizing bank holding companies to organize and manage closed-end investment companies within carefully prescribed restrictions, the Federal Reserve Board applied these statutes according to their plain meaning. The Board found both that the authorized activities were within the limits of the Glass-Steagall Act and were closely related to traditional banking

services as required under the Bank Holding Company Act. In setting aside the Board's regulation and interpretive ruling, the court of appeals did not disagree with the Board's analysis of the Glass-Steagall Act. Rather, the court read into the Bank Holding Company Act an implied prohibition against "securities activities" by bank holding companies. The court concluded that Congress believed that the Glass-Steagall Act prohibited a bank holding company to provide investment management services to closed-end investment companies when the Bank Holding Company Act was enacted, even though that belief "may have been mistaken" (Pet. App. 24a-25a, 28a-29a, 42a-44a).

In reaching its decision, the court of appeals failed to adhere to the literal text of the relevant statutes and misconstrued the legislative history. The statutes and their history show that Congress intended to empower the Board to authorize activities that are closely related to banking if those activities do not result in bank holding companies' becoming principally engaged in the issuance or distribution of securities. Application of these standards confirms that the Board properly authorized bank holding companies to organize and manage closed-end investment companies within the limitations prescribed in its regulation and interpretive ruling.

In the pages below, we first demonstrate that the investment management activities approved by the Board are consistent with the provisions of the Glass-Steagall Act. We then show that they are consistent with the provisions of the Bank Holding Company Act.

I. THE GLASS-STEAGALL ACT PERMITS BANK HOLDING COMPANIES TO ORGANIZE AND MANAGE CLOSED-END INVESTMENT COMPANIES WITHIN THE LIMITATIONS PRESCRIBED BY THE BOARD

In issuing its regulation and interpretive ruling, the Board acknowledged that the Glass-Steagall Act applies to bank holding companies serving as investment managers. It nonetheless determined that the Glass-Steagall Act does not prevent a bank holding company from serving in that capacity for a closed-end investment company subject to the limitations that the Board prescribed in its interpretive ruling. 12 C.F.R. 225.125.[10] That determination, undisturbed by the court of appeals, is correct.

A. The Glass-Steagall Act forbids affiliates of banks to engage "principally" in the issuance or distribution of securities

In addressing the requirements of the Glass-Steagal Act, the starting point must be the language of the statute itself. See, *e.g.*, *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, No. 77-1645 (Nov. 13, 1979), slip op. 4. As both the Board and court of appeals recognized, Congress enacted several provisions in the Glass-Steagall Act that prescribe distinct and separate standards (Pet. App. 54a-55a; 17a-21a). In particular, Congress prescribed different rules for banks and bank affiliates, such as bank holding com-

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[10] The Board explained, however, that organization and management of an *open-end* investment company (mutual fund) is forbidden under the Glass-Steagall Act. 12 C.F.R. 225.125(f).

panies and companies under common control with banks.

Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides that national banks may not underwrite any issue of securities or stock. Section 16 also provides that national banks may buy and sell certain categories of securities only for the account of customers and not for their own account.[11] In addition, Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids organizations engaged in the business of issuing, underwriting, selling, or distributing securities to engage in the business of receiving deposits—the business of banking. Where applicable, Sections 16 and 21 impose an unqualified prohibition. See *Investment Company Institute* v. *Camp*, 401 U.S. 617, 624-625, 639 (1971).

The Glass-Steagall Act prescribes less stringent rules for organizations that are "affiliated" with commercial banks. As originally enacted, the Glass-Steagall Act contained a provision specifically regulating affiliates that were bank holding companies. In Section 19(e) of the Act, 12 U.S.C. (1964 ed.) 61 (e), Congress provided that a bank holding company could not vote the shares of a bank subsidiary without a permit from the Board and that a permit would not be granted unless the holding company agreed to divest itself within five years of its controlling interest in any company formed for the pur-

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[11] State banks that are members of the Federal Reserve System are subject to the same restrictions that apply to national banks. 12 U.S.C. 335.

pose of or "engaged principally in" the issuance or underwriting of securities.[12] Similarly, Sections 2(b)(2) and 20 of the Act, 12 U.S.C. (1964 ed.) 221a(b)(2) and 377, provided that a member bank could not be under common control with a corporation "engaged principally" in the issuance or underwriting of securities.[13]

In 1966, Congress repealed the bank holding company provision contained in Section 19(e). See 80 Stat. 242-243; *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243-244 (1978). At the same time, Congress enlarged the coverage of Section 20 by amending the definition of "affiliate" in Section 2(b) of the Act to include bank holding companies. See 80 Stat. 242 (12 U.S.C. 221a(b)(4)). As a result of the repeal of Section 19(e) and the enlargement of the coverage of Section 20, the voting permit procedure was superseded and bank holding companies became subject to the prohibition in Section 20 against engaging "principally" in the issuance or underwriting of securities.

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[12] Section 19(e) did not prohibit bank holding companies to own investment banking subsidiaries. Rather, the statute provided that permission to vote the shares of a national bank subsidiary was contingent on the holding company's divestiture within five years of its interest in investment banking firms.

[13] As originally enacted, Sections 2(b)(2) and 20 covered various kinds of non-holding company affiliates. 48 Stat. 162, 188. See also Section 32 of the Act, 12 U.S.C. 78, barring, *inter alia*, interlocking directorates between banks and business firms "primarily engaged" in the issuance or underwriting of securities.

Both Section 20 and its predecessor, Section 19(e), utilize the "engaged principally" standard. In contrast to the provisions applicable to banks (Sections 16 and 21), the provisions regulating bank affiliates do not prescribe an unqualified prohibition against underwriting or distributing securities. As this Court has recognized, the difference in strictness of the standards prescribed in the several provisions of the Glass-Steagall Act was deliberate. See *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-448 (1947):

> Section 20 of the Act outlaws affiliation of a member bank with an organization "engaged principally" in the underwriting business. Section 19 provides control over bank holding companies. In order to vote its stock in controlled banks a bank holding company must show that it does not own, control or have any interest in, and is not participating in the management or direction of any organization "engaged principally" in the underwriting business. On the other hand, when Congress came to deal with the practice of underwriters taking checking deposits, it used language different from what it used in §§ 19 and 20 * * *. By § 21 it prohibited any organization "engaged" in the underwriting business "to engage at the same time to any exent whatever" in the business of receiving checking deposits. Thus within the same Act we find Congress dealing with several types of underwriting firms—those "engaged" in underwriting, those "primarily engaged" in underwriting, those "engaged principally" in under-

> writing. The inference seems reasonable to us that Congress by the words it chose marked a distinction which we should not obliterate * * *.

As the statutory pattern summarized above demonstrates, the provisions of the Glass-Steagall Act applicable to bank affiliates (including bank holding companies and companies subject to common control with banks) are Section 20 of the Act, and its predecessor, Section 19(e).[14] The test that Congress has prescribed under those provisions is whether a bank affiliate is "engaged principally"—as opposed to incidentally—in the issuance or distribution of securities.[15]

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[14] The Board consistently has held that Section 20 governs the securities activities of bank holding companies and their non-bank subsidiaries. See 12 C.F.R. 250.221; *Financial Services Corporation of the Midwest*, 63 Fed. Res. Bull. 948 & n.2 (1977).

[15] In light of the statutory pattern summarized above, both the Board and the court of appeals correctly determined that respondent's challenge to the Board's regulation and interpretive ruling based on Sections 16 and 21 of the Glass-Steagall Act is without merit. Section 21 of the Glass-Steagall Act, 12 U.S.C. 378, forbids a corporation to engage in both the business of underwriting and the business of receiving deposits (commercial banking). As the Board noted, the literal language of this provision shows that it is inapplicable to a bank holding company or a non-banking subsidiary that does *not* receive deposits (Pet. App. 54a-56a). The court of appeals agreed, explaining that "Congress, in the Glass-Steagall Act, did indeed intend to regulate the activities of bank holding companies and their non-bank subsidiaries—but *not* in Section 21 of the Act" (Pet. App. 20a-21a). Likewise,

B. A closed-end investment company that issues its shares only when it commences business and on infrequent occasions thereafter is not "engaged principally" in the issuance or distribution of securities

Under the Board's regulation and interpretive ruling, a bank holding company (and its non-bank subsidiaries) are authorized to "control" a closed-end investment company. Even if such an investment company is deemed to be a bank "affiliate" by reason of that control,[16] the closed-end investment company does not engage "principally" in the issuance or distribution of securities in violation of Section 20 of the Glass-Steagall Act.[17]

As the court of appeals correctly pointed out, a closed-end investment company "typically does not issue shares after its initial offering except at infrequent intervals, and does not stand ready to redeem them" (Pet. App. 6a). A closed-end investment company is no more engaged in the issuance or distribu-

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Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, applies, by its terms, only to banks. As the Board pointed out, the challenged regulation and interpretive ruling only authorize fiduciary activities by bank holding companies, not banks (Pet. App. 60a-61a). The court of appeals concurred in that interpretation (Pet. App. 21a-23a).

[16] We assume, arguendo, that under some circumstances a closed-end investment company managed by a bank holding company could be deemed a bank "affiliate." See 12 U.S.C. 221a(b)(2); but see note 7, *supra*.

[17] The word "principal" means "chief," "main" or "important." See *Webster's New International Dictionary* 1966 (1936); *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 446.

tion of securities than is any publicly held corporation.[18] As explained by the Securities and Exchange Commission in its *Report On The Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 42-43 (1966) ("Report on Public Policy Implications"):

> Since a closed-end company is under no obligation to redeem, that is, buy back its own shares, its capital structure is much like that of companies in other areas of the economy. Equity capital contributed by the public is viewed as permanently committed to the enterprise * * * * * * * * *. [C]losed-end companies do not continuously issue new shares; and since the tendency of their shares to sell at a discount from net asset value normally precludes them from publicly offering new shares, infusions of new capital are rare.

Accord, *SEC Report on Investment Trusts and Investment Companies* (Part 1), H.R. Doc. No. 707, 75th Cong., 3d Sess. 26-27 (1938) ("Report On Investment Trusts"); see also Pet. App. 84a; Section 5(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(a). Thus, the principal activity of a closed-end investment company is to invest and re-

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[18] Closed-end investment companies, issuing their shares when organized and on infrequent occasions thereafter, are similar to ordinary corporations that "go public." Banks and bank holding companies, of course, issue their own securities when they are organized. See, *e.g.*, 12 U.S.C. 51 *et seq.* No one has ever suggested that the securities activity involved in an initial capitalization infringes any provision of the Glass-Steagall Act.

invest the assets that have been "permanently contributed to the enterprise."

Because closed-end investment companies, in contrast to open-end investment companies (mutual funds), do not continuously issue and sell their own securities, but instead generate capital through a single offering of non-redeemable securities when the company commences business, the Board repeatedly has determined that closed-end investment companies are not "primarily engaged" in the issuance or distribution of securities. See 25 Fed. Reg. 3464 (1960), 12 C.F.R. 218.102; 26 Fed. Reg. 868-869 (1961), 12 C.F.R. 218.104(d).[19] It follows a fortiori that they are not "principally engaged" in the issuance or distribution of securities within the meaning of Section 20 of the Glass-Steagall Act. See

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[19] Open-end investment companies, in contrast to closed-end companies, engage in a continuous process of redeeming and issuing their shares. See *United States* v. *National Association of Securities Dealers*, 422 U.S. 694, 698 (1975): "In order to avoid liquidation through redemption, mutual funds continuously issue and sell new shares. These features—continuous and unlimited distribution and compulsory redemption—are, as the Court recently recognized, 'unique characteristics' of this form of investment." See also *id.* at 698 n.2.

Because open-end investment companies issue their shares continuously to offset redemptions and to prevent contraction of their assets, the Board has determined that they are "primarily engaged" in the issuance and sale of securities. See 16 Fed. Reg. 4963 (1951), 12 C.F.R. 218.101. Consistent with this interpretation, the Board prescribed in its interpretive ruling here that a bank holding company may not organize or manage an open-end investment company. See 12 C.F.R. 225.125(f).

Board of Governors of the Federal Reserve System v. *Agnew*, *supra*, 329 U.S. at 446-449 ("principal" engagement in issuance or distribution of securities may be somewhat greater than "primary" engagement); Pet. App. 77a.

The Board's regulation puts to rest any doubt on this question by allowing bank holding companies and their non-bank subsidiaries to organize and manage *only* those investment companies that "are not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. 225.125 (f).[20]

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[20] In some instances, there may be overlapping employment relationships or interlocking directors between an investment company and a subsidiary bank of a bank holding company investment adviser. Under Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, such interlocks are forbidden if the investment company engages "primarily" in the issuance or distribution of securities. As previously noted, the Board consistently has determined that *closed-end* investment companies are not engaged "primarily" in the issuance or distribution of securities. The Board's regulation and ruling here expressly forbid affiliation with any investment company that engages primarily or frequently in the sale or distribution of securities. Thus, an overlapping director or employment relation between a bank and a closed-end investment company could not violate Section 32 of the Glass-Steagall Act.

That conclusion is reinforced by Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. 80a-10(c), which regulates director interlocks between banks and investment companies. This statutory provision clearly demonstrates that Congress did not intend to foreclose director interlocks

C. A bank holding company that organizes and manages a closed-end investment company within the limitations prescribed by the Board is not "engaged principally" in the issuance or distribution of securities

A bank holding company (or a non-bank subsidiary of the holding company) that controls a subsidiary bank is a bank "affiliate" subject to the restrictions of Section 20 of the Glass-Steagall Act. See 12 U.S.C. 221a(b), 377, 1841(a). Section 20 therefore requires that such a bank holding company not engage "principally" in the issuance or distribution of securities. The Board's regulation and interpretive ruling prescribe a code of restrictions to assure that the fiduciary function of managing a closed-end investment company does not result in a bank holding company's becoming engaged principally, if at all, in the issuance or distribution of securities. 12 C.F.R. 225.125. Under the Board's regulation and interpretive ruling, any connection between the bank holding company and the issuance or distribution of the securities of its investment company advisee is remote and incidental.[21]

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between banks and *all* investment companies. While a director interlock with an open-end investment company would be prohibited by Section 32 of the Glass-Steagall Act, Section 32 and Section 10(c) of the Investment Company Act permit interlocks (subject to regulatory requirements) between banks and closed-end investment companies.

[21] Investment advisers typically organize, manage, and provide miscellaneous services to their client investment companies. See *Burks* v. *Lasker*, 441 U.S. 471, 480-481 (1979). See also *Wharton School Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. 476-477 (1962); *SEC Insti-*

In organizing and managing a closed-end investment company, a bank holding company does not itself "issue" securities.[22] Moreover, under the Board's regulation and interpretive ruling, bank holding companies are permitted to manage only closed-end investment companies. See 12 C.F.R. 225.125(f). Because a closed-end investment company issues shares only infrequently, organization and management of such an entity could not cause its adviser to become "principally engaged" in the business of issuing securities. The principal function of a bank holding company managing a closed-end investment company is to invest and reinvest the assets that initially have been contributed to the closed-end investment company.

Nor does the bank holding company investment adviser engage principally, if at all, in the "flotation, underwriting, public sale, or distribution" of securi-

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tutional Investor Study Report, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 167-168, 207-208 (1971). Under the Board's regulation and interpretive ruling, a bank holding company (or its non-bank subsidiary) would be free to organize and manage the client investment company, to select its investments, and to provide ancillary services including custodial and clerical assistance. See 12 C.F.R. 225.125(i).

[22] The securities issued by a closed-end investment company are, of course, the securities of that company, not the securities of the investment adviser. The investment company is the entity that "issues or proposes to issue any security" (see Section 2(4) of the Securities Act of 1933, 15 U.S.C. 77b(4); Section 2(a)(22) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(22))—*i.e.*, the entity that creates the rights and obligations evidenced by the security.

ties. To assure that bank holding companies engage principally in the fiduciary activity of investment management, rather than the underwriting of securities, the Board has prescribed that bank holding companies may not "directly or indirectly" sell or distribute the shares of investment companies. 12 C.F.R. 225.125(h). That underwriting task must be performed solely by a distributor or investment banker unaffiliated with the bank holding company. The Board's interpretive ruling also provides that "[p]rospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company." *Ibid.* Thus, even with respect to closed-end investment companies that issue securities only on an infrequent basis, the Board's regulation completely divorces the bank holding company from the process by which securities are disseminated. This segregation of the underwriting and investment management functions assures that the services performed by the bank holding company are "principally" fiduciary services, not investment banking services in violation of Section 20 of the Glass-Steagall Act.[23]

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[23] Throughout its opinion, the court of appeals intimates that management of a closed-end investment company is somehow similar to engaging in "investment banking" (Pet. App. 29a & n.32, 30a). The court does not explain, however, how managing a closed-end investment company within the restrictions prescribed by the Board is akin to the business of investment bankers who purchase and resell the securities of corporate issuers or assist in the distribution and promotion

D. The Board's regulation and interpretive ruling prescribe safeguards to prevent conflicts of interest and unsound banking practices of the kind that concerned Congress when the Glass-Steagall Act was enacted

This Court's decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), reviews the legislative history of the Glass-Steagall Act and summarizes the concerns that led to the enactment of that statute. The holding in *Camp* is not directly relevant here, since the Court there construed Sections 16 and 21 of the Glass-Steagall Act—provisions that apply to banks—and did not rule on the scope of the different provisions that apply to bank "affiliates." As previously noted, the provisions of the Glass-Steagall Act applicable to affiliates are less stringent than those applicable to banks. See *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 447-448.[24]

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of those securities. The business of investment banking consists in channeling new offerings to the investing public, not in managing the portfolio of an investment company advisee for an annual fee. See I L. Loss, *Securities Regulation* 159-178 (1961). In short, management of a closed-end investment company does not give rise to the "needs and interests" of investment banking. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 637. The court of appeals compounds the semantic confusion by referring repeatedly to "the abuses stemming from bank involvement in the *securities* business" (Pet. App. 39a) (emphasis in original). However, as the literal text of the Glass-Steagall Act makes clear, Congress did not intend to prohibit purchasing and selling securities in a fiduciary capacity for the account of customers. See Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh; H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935); 12 U.S.C. 92a.

[24] We also note that the activities authorized for bank holding companies by the Board's regulation and ruling are fun-

Nonetheless, in promulgating its regulation and interpretive ruling, the Board was sensitive to the policy concerns that the Glass-Steagall Act embodies, as summarized by this Court in the *Camp* decision. See Pet. App. 83a-85a. The restrictions contained in the Board's interpretive ruling were specifically formulated to prevent conflicts of interest and unsound banking practices of the kind discussed in *Camp*.

The overriding purpose of the Glass-Steagall Act is to safeguard banks from losses and risks attendant upon participation in the speculative business of investment banking. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629-630.[25] Under the Board's regulation and interpretive ruling, that danger is entirely avoided. The Board's ruling prohibits bank holding companies (and their bank and

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damentally different from those performed by the bank in the *Camp* case. In *Camp*, the bank was the underwriter of the fund's shares, the fund issued redeemable shares and thus re issued its shares continuously, the fund was made available principally to customers of the bank and was held out as a service of the bank, and the fund bore the name of the bank. 401 U.S. at 622-626 & n.12. Under the Board's regulation and ruling, none of these activities or relationships is permissible.

[25] Congress enacted the Glass-Steagall Act during a period of unprecedented bank failures. Between 1921 and 1929, approximately 5,700 banks became insolvent. See Lehr, *The Affiliation of Commercial Bank and Mutual Fund Personnel (Part I)*, 83 Banking L.J. 377, 384 (1966); S. Rep. No. 77, 73d Cong., 1st Sess. 8, 10 (1933); 75 Cong. Rec. 9910 (1932) (remarks of Sen. Bulkley); *Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131, 133-134 (7th Cir. 1973).

non-bank subsidiaries) from purchasing interests in or lending money to an advisee investment company. 12 C.F.R. 225.125(g). Thus, the capital of banks and their affiliates is not placed at risk through investments in or loans to the investment company. See *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630, 638.[26]

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[26] When it enacted the Glass-Steagall Act, Congress expressed concern over the risks created by "securities affiliates." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629; 77 Cong. Rec. 3725 (1933) (remarks of Sen. Glass); S. Rep. No. 77, *supra*, at 10. Those affiliates engaged in "perilous underwriting operations, stock speculation, and maintaining a market for the bank's own stock often largely with the resources of the parent bank." *Ibid.*; see also 75 Cong. Rec. 9909-9913 (1932) (remarks of Sen. Bulkley); 75 Cong. Rec. 9887 (1932) (remarks of Sen. Glass); *Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency* (Part VII), 71st Cong., 3d Sess. 999-1001, 1052-1068 (1931). As this Court noted in *Camp*, securities affiliates operated to a significant extent with funds borrowed from their parent banks. 401 U.S. at 631 n.31. Those securities affiliates bear no resemblance to the closed-end investment companies covered by the Board's regulation and ruling. The securities affiliates described by Congress were merely vehicles for investing the bank's own funds in speculative securities, for channeling the funds of bank shareholders into speculation, or for engaging in wholesale or retail investment banking. Thus, contrary to the suggestions of the court of appeals (Pet. App. 26a-28a), the legislative history contains no indication that Congress intended to foreclose the limited fiduciary services at issue in this case.

We also note that the court of appeals draws unwarranted inferences from the legislative history that cannot be squared with the legislation that was actually enacted by Congress. Thus, the court infers that the purpose of the Glass-Steagall Act was to separate as far as possible national and member banks "from affiliates of all kinds" (Pet. App. 29a). However, as discussed on pages 19-23, *supra*, Congress dealt with the

The Board's interpretive ruling imposes additional restrictions to eliminate "the more subtle hazards" that the Glass-Steagall Act sought to avoid. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630. As noted in *Camp*, unsound banking practices may result when a bank operates a mutual fund, which requires it to engage in the business of aggressively marketing securities. 401 U.S. at 631, 632-633, 637-638. The Board's regulation and interpretive ruling eliminate this promotional pressure. As previously noted, a closed-end investment company does not issue redeemable shares and is not continuously engaged in the offer and sale of securities. A closed-end investment company does not face the prospect of liquidating its assets or selling new shares to cover redemptions. Operation of a closed-end investment company does not require the manager to serve as the functional equivalent of an investment banker or underwriter. See 401 U.S. at 632-636.[27] Thus, a

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abuses that it found to exist through statutory provisions prescribing specific rules. Those provisions do not forbid *all* affiliates. Affiliates not engaged "principally" or "primarily" in issuing or underwriting securities were not divorced from banks. Moreover, contrary to the conclusion of the court of appeals (Pet. App. 28a n.30), banking organizations have continued to sponsor and organize closed-end investment companies following the enactment of the Glass-Steagall Act. See *SEC Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 58, 124 (Table 25) (1939). See also pages 53-56, *infra*.

[27] The stable capital base of a closed-end investment company has been noted in studies of investment companies:

> Equity capital contributed by the public is viewed as permanently committed to the enterprise * * *. The

bank holding company that manages a closed-end investment company has no "particular investment to sell." *Id.* at 636. The manager does not stand to gain from resales of shares of a closed-end investment company that may occur between brokers or dealers or on the open market. There is no incentive for the bank holding company to promote continuously the sale of the closed-end investment company's shares.[28]

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company is not engaged in a continuous quest for new equity capital.

Public Policy Implications Of Investment Company Growth, supra, at 42. Investment advisers serving investment companies receive a fee that is generally a fixed percentage of the value of the assets under management. *Id.* at 8, 42. In the case of closed-end investment companies, that fee increases only through an increase in the value of the company's investment portfolio—not (as in the case of an open-end investment company) through the sale of additional shares. See *SEC Report of Special Study of Securities Markets,* H.R. Doc. No. 95 (Part 4), 88th Cong., 1st Sess. 204-205, 96-99 (1963).

[28] Respondent has acknowledged the absence of promotional pressures in managing closed-end investment companies (Hearings before the Board of Governors of the Federal Reserve System, Nov. 12, 1971, Tr. 15, testimony of G. Duane Vieth):

> In our judgment, the most serious of those conflicts of interest relate to this promotional aspect, this concern by the bank or its affiliates in constantly selling the shares, and that, as I say, is not typical of a closed-end company. So, I would have to be frank to say to you that the serious conflicts that we see are not present with respect to closed-end companies.

Moreover, even if there were such an incentive, promotional and underwriting activities of any kind are flatly forbidden under the Board's interpretive ruling.

The Board's interpretive ruling also eliminates practices that could impair the public's attitude toward the holding company and its bank subsidiaries. Thus, to avoid injury to a holding company's reputation that could result from poor performance of its advisee's investment portfolio (401 U.S. at 631), the Board has prohibited bank holding companies from serving as advisers to investment companies with names similar to those of the holding company or any of its subsidiary banks. 12 C.F.R. 225.125(f). And to avoid the possibility that depositors might lose confidence in the holding company or its subsidiary banks (401 U.S. at 631), the Board has prohibited bank holding companies from distributing sales literature concerning investment company advisees. Likewise, the names of bank customers may not be furnished to distributors or underwriters who sell shares of advisee investment companies. 12 C.F.R. 225.125 (h).

Finally, to avoid the possibility that advising an investment company may conflict with "the obligation of the commercial banker to provide disinterested investment advice" (401 U.S. at 633, 636-637), the Board also has forbidden bank holding companies and their subsidiaries to exercise fiduciary powers to purchase securities of advisee investment companies. 12 C.F.R. 225.125(g). Similarly, the Board has forbid-

den the employees of subsidiary banks from expressing any opinion with respect to the shares of the advisee. 12 C.F.R. 225.125(h). And to reduce the likelihood that a subsidiary bank might extend credit "to facilitate the purchase of interests" in the investment company advisee (401 U.S. at 638), the interpretive ruling forbids bank holding companies and their subsidiaries from accepting the securities of advisees as collateral for loans to purchase such securities. 12 C.F.R. 225.125(g).[29]

E. The Board's determination that bank holding companies may manage closed-end investment companies without infringing the Glass-Steagall Act is entitled to judicial deference

The Board's conclusion that a bank holding company—operating within the limitations prescribed in its regulation and interpretive ruling—may manage a closed-end investment company without infringing

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[29] Of course, many services offered by banks involve promotional activity. For example, banks aggressively promote their traditional trust services. See, *e.g.*, W. Kennedy and P. Searle, *The Management of a Trust Department* 83-119 (1967); *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 644 (Blackmun, J., dissenting). The existence of promotional activity, by itself, does not give rise to Glass-Steagall Act violations, so long as the banking organization is effectively segregated from the underwriting process and the issuance of securities is infrequent. Thus, the actions of a bank holding company engaged in organizing and managing an investment company within the strictures prescribed by the Board do not amount to forbidden promotion of investments—"In short there is a plain difference between the sale of fiduciary services and the sale of investments." *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 638.

the Glass-Steagall Act is entitled to judicial deference. The Board is one of the government agencies primarily responsible for enforcing the Glass-Steagall Act.[30] The Board's experience in enforcing the Act and in determining what safeguards are required to protect the public interest justifies invocation of the general principle that "considerable respect is due the 'interpretation given [a] * * * statute by the officers or agency charged with its administration.'" *Ford Motor Credit Co.* v. *Milhollin*, No. 78-1487 (Feb. 20, 1980), slip op. 10. As Justices Rutledge and Frankfurter explained in their concurring opinion in *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*, 329 U.S. at 450 (construing the Glass-Steagall Act): "Not only because Congress has committed the system's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated judgment in all its phases, I think their judgment should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion." This Court repeatedly has applied that rule in upholding the Board's statutory interpretations and in sustaining its regulations. See, *e.g.*, *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248, 251 (1978) ("[C]ourts should defer to an agency's construction of its own statutory mandate"); *Mourning* v. *Family*

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[30] The Board is empowered to assess substantial civil penalties for violations of Section 20. See 12 U.S.C. 377.

Publications Service, Inc., 411 U.S. 356, 369 (1973) ("the validity of a regulation * * * will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation' ").

These principles apply here and require affirmance of the Board's determination that a bank holding company, acting within the restrictions prescribed by the Board, may be permitted to organize and manage a closed-end investment company without infringing the Glass-Steagall Act.

II. SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT OF 1956 EMPOWERS THE BOARD TO DETERMINE THAT ORGANIZATION AND MANAGEMENT OF A CLOSED-END INVESTMENT COMPANY ARE ACTIVITIES CLOSELY RELATED TO BANKING AND THUS ARE PERMISSIBLE FOR A BANK HOLDING COMPANY

Although the court of appeals rejected respondent's contention that the Glass-Steagall Act forbids bank holding companies to manage closed-end investment companies, it nonetheless reached the conclusion that the Board may not authorize such activities under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8). In so holding, however, the court of appeals disregarded the plain meaning of Section 4(c)(8), which delegates to the Board discretionary authority to determine which activities are closely related to banking and thus are permissible for bank holding companies. The court likewise overlooked the structure of the Act and misconstrued the legislative history.

A. Section 4(c)(8) vests in the Board authority to determine which activities are "closely related" to banking

Section 4(c)(8) authorizes bank holding companies to acquire shares of any company the activities of which "the Board * * * has determined * * * (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." [31] By its terms, Section 4(c)(8) neither authorizes nor prohibits particular business activities. The statute delegates the task of delineating permissible non-banking activities to the Board, the expert agency.[32]

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[31] Section 4(c)(8) is one of several exemptions from the general prohibition contained in Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), which forbids a bank holding company to acquire shares of any company that is not engaged in the activity of banking. Under Section 4(a)(2) of the Act, 12 U.S.C. 1843(a)(2), a bank holding company may not engage "in any activities other than (A) those of banking or of managing or controlling banks * * * (B) those permitted under paragraph (8) of subsection (c) of this section * * *." In addition to Section 4(c)(8), other provisions of the Bank Holding Company Act permit bank holding companies to engage in activities beyond those of banking and managing banks. See, *e.g.*, Sections 4(c)(6) and 4(c)(7), 12 U.S.C. 1843(c)(6), (7), which permit bank holding companies to purchase, within limits, equity securities for their own account—activities plainly impermissible for banks.

[32] See *National Courier Ass'n* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, 568 F.2d 549, 551-552 (7th Cir. 1978).

On its face, Section 4(c)(8) does not exclude securities-related activities from the realm of activities that are closely related to banking. And since Congress has long authorized national banks to serve in various fiduciary capacities involving securities (see 12 U.S.C. 92a; 12 U.S.C. 24 Seventh), no such limitation can logically be implied. Commercial banks today are the nation's largest portfolio managers. See *SEC Institutional Investor Study Report, supra,* at 413-494. At the end of 1978, trust departments of insured commercial banks managed over $441.8 billion in assets. *American Banker,* Nov. 16, 1979 at 1, col. 1. Bank trust departments administer common trust funds, employee benefit trusts, institutional and corporate agency accounts, as well as personal trust and agency accounts. See *SEC Institutional Investor Study Report, supra*; see also 12 C.F.R. 9.18 (prescribing rules for collective investment funds managed by national bank trust departments). In short, discretionary investment management services "ha[ve] been a traditional banking function as long as there have been banks" (Pet. App. 57a).[33]

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[33] As the American Bankers Association stated in its comment on the Board's proposed rule: "The fact that this type of activity is closely related to banking and is consistent with the traditional role of banks in serving fiduciary customers is clearly evidenced. For well over a century, banks and trust companies in every state have managed and administered customers' investment funds * * *" (A. 20). The close connection between the activities authorized by the Board's regulation and traditional banking services is discussed further on pages 53-56, *infra.*

The structure of the Bank Holding Company Act reinforces the conclusion that Congress did not intend to forbid a bank holding company to manage a closed-end investment company. Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly permits bank holding companies to acquire and own the shares of investment companies.[34] Since a bank holding company is empowered to manage, control, and provide services to all of its subsidiaries,[35] a bank holding company clearly may manage, control, and advise a subsidiary investment company. Moreover, because the language of Section 4(c)(7) permits a bank holding company to acquire any or all of the shares of an investment company, it follows that a bank holding company may manage an investment company in which other investors have an interest.[36] In light of this express authorization to own, control, and manage an investment company subsidiary,

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[34] The statute imposes certain limitations, not relevant here, on the type of investment company shares that may be acquired by a bank holding company. The investment company may not be a bank holding company, may not engage in any business other than investing in securities, and may not hold more than 5% of the shares of any corporation. 12 U.S.C. 1843(c)(7).

[35] See 12 U.S.C. 1843(a)(2)(A).

[36] While Congress was evidently considering the case of a wholly owned investment company when it enacted Section 4(c)(7) (see 102 Cong. Rec. 6851-6854 (1956)), the language of the provision is not so limited. Supporters of the provision repeatedly acknowledged that it would apply to any investment company meeting the statutory criteria. See 102 Cong. Rec. 6852 (1956) (remarks of Sen. Barkley).

it is illogical to contend that Congress believed that rendering management services to an investment company is an inappropriate activity for a bank holding company under the flexible standard of Section 4(c)(8).

B. The legislative history of Section 4(c)(8) shows that Congress intended to vest discretion in the Board to authorize business activities closely related to banking that are not forbidden by the Glass-Steagall Act

The legislative history of Section 4(c)(8) confirms that Congress intended the Board to exercise its expert judgment in designating activities that are closely related to banking and did not mean to proscribe securities-related activities other than those expressly forbidden by the Glass-Steagall Act. Nothing in the legislative history supports the view of the court of appeals that Congress believed that organization and management of a closed-end investment company are impermissible activities for a bank holding company.[37]

1. The Bank Holding Company Act, ch. 240, 70 Stat. 133, as originally enacted in 1956, provided in Section 4(c)(6) (the predecessor of Section 4(c)(8)), that bank holding companies may acquire:

> shares of any company * * * the activities of which are of a financial, fiduciary, or insurance

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[37] This Court reviewed the legislative history of the Bank Holding Company Act in *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp., supra,* 439 U.S. at 243-247.

> nature and which the Board * * * has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto * * *.

70 Stat. 137. Like the current Section 4(c)(8), Section 4(c)(6) delegated to the Board the task of delineating permissible activities. As the Senate Report explained (S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955)):

> In the opinion of your committee, certain activities of a financial, fiduciary, or insurance nature are obviously so closely related to banking as to require no divestment by a bank holding company. * * * [T]here are many * * * activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

Congress' awareness of the fact that the Board could lawfully authorize bank holding company activities involving securities is evident from the fact that Section 4(c)(6) extended to "financial" or "fiduciary" services.

Congress intended the Bank Holding Company Act of 1956 to remedy inadequacies in prior holding company legislation, *i.e.*, Section 19 of the Glass-Steagall

Act (12 U.S.C. (1964 ed.) 61). See *Board of Governors of Federal Reserve System* v. *First Lincolnwood Corp.*, *supra*, 439 U.S. at 243-244. (Section 19 is discussed on pages 20-21, *supra*). The 1956 legislation strengthened the Board's regulatory authority over bank holding companies, but there is no suggestion that Congress believed that operation of a closed-end investment company was improper under the Glass-Steagall Act or should be forbidden under the Bank Holding Company Act.[38]

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[38] The major premise on which the court of appeals rests its analysis of the Bank Holding Company Act is the assertion that the 1956 legislation was not "broad" enough to embrace management of a "closed-end investment company" (Pet. App. 30a). However, the court cites nothing in the text or history of the Act which supports that assertion. Instead, the court invokes the "over-arching policy" of the Glass-Steagall Act "of divorcing investment from commercial banking" (*ibid.*). However, as we have previously demonstrated, management of a closed-end investment company within the limitations prescribed by the Board is not "investment banking." Moreover, the divorce between investment and commercial banking that is relevant in the case of bank affiliates is prescribed by Section 20 of the Glass-Steagall Act—a provision that only forbids bank affiliates to become "principally" engaged in issuing or underwriting securities. That provision does not prevent a bank holding company from managing a closed-end investment company that issues shares only infrequently. In sum, the court of appeals imputes to the Glass-Steagall Act a prohibition that it does not contain. Nor is there any basis for the court of appeals' inference (Pet. App. 44a) that Congress "may have been mistaken" about the meaning of the terms of the Glass-Steagall Act when it enacted the Bank Holding Company Act. The court of appeals cites no evidence that Congress misapprehended the plain meaning of the statutory provisions that it had previously enacted—provisions that this Court had authorita-

2. The 1966 amendments to the Bank Holding Company Act did not alter the Board's mandate to authorize activities closely related to the business of banking.[39] The only change resulting from the 1966 legislation that is relevant for present purposes is Congress' repeal of Section 19(e) of the Glass-Steagall Act and its abandonment of the voting permit procedure.[40] See 80 Stat. 242-243. As noted on page 21, *supra*, at the time that Congress repealed Section 19(e) of the Glass-Steagall Act, it simultaneously enlarged the coverage of Section 20 of the Glass-Steagall Act to make that provision applicable to bank holding companies.[41] Thus, the standard of securities-relatedness that Congress contemplated would apply to bank holding companies when it amended the Bank Holding Company Act in 1966 is the standard expressed in Section 20—that such bank

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tively construed in 1947 in *Board of Governors of the Federal Reserve System* v. *Agnew*, *supra*. See also *Barrett* v. *United States*, 423 U.S. 212, 217 (1976).

[39] In 1966, Section 4(c)(6) was renumbered Section 4(c)(8) without substantive change. See 80 Stat. 239.

[40] Section 19(e) was a largely ineffective provision. A bank holding company could escape regulation entirely simply by declining to vote its shares in the subsidiary bank. See S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955); S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

[41] Congress enlarged the coverage of Section 20 by amending the definition of "affiliate" contained in 12 U.S.C. 221a(b). See 80 Stat. 242; page 21, *supra*. Prior to 1966, Section 20 did not apply to bank holding companies. Section 20 applied only to entities under common control with member banks and direct subsidiaries of banks. See 48 Stat. 162-163.

affiliates may not engage "principally" in the issuance or underwriting of securities. There is no suggestion in the history of the 1966 legislation that Congress intended to preclude bank holding companies from serving as investment advisers to closed-end investment companies, which issue their shares only on an infrequent basis.

3. The 1970 amendments to the Bank Holding Company Act revised Section 4(c)(8) and produced the current text of that provision. See 84 Stat. 1765. Once again, Congress reaffirmed that it intended the Board to draw the line between permissible and impermissible non-bank activities and that it did not wish to preclude the Board from approving any business activities closely related to banking except those activities forbidden by the Glass-Steagall Act.

As amended, Section 4(c)(8) authorizes the Board to permit a bank holding company to acquire "shares of any company the activities of which the Board * * * has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 84 Stat. 1765. The 1970 amendments did not contract the range of activities that the Board was empowered to approve.[42]

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[42] In fact, Congress enlarged the range of activities covered by the statute. The 1970 amendments replaced the phrase "business of banking" appearing in the original version of Section 4(c)(8) with the word "banking." 84 Stat. 1765. The Board had interpreted the phrase "business of banking" to require a close connection between the proposed new activities of a bank holding company and the activities in which it

In discussing the 1970 revision of Section 4(c)(8), the Chairman of the Conference Committee emphasized repeatedly that the statute was not intended to change the rules prescribed under the Glass-Steagall Act. To the contrary, the Glass-Steagall Act defined the outer boundaries of permissible activities under Section 4(c)(8). See 116 Cong. Rec. 42430 (1970) (emphasis supplied):

> [Senator] Williams. Both the Senate and House bills contained, in section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides, essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may

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actually engaged. Under the amended language, only a close connection between the proposed activity and the business generally conducted by banks is required. H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 21 (1970); S. Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970). Thus, contrary to the view of the court of appeals (Pet. App. 38a), the 1970 amendment to Section 4(c)(8) contemplated some enlargement of the lines of business in which bank holding companies could lawfully engage. See 116 Cong. Rec. 42423-42424, 42435 (1970) (remarks of Sens. Sparkman and Bennett).

The 1970 amendments also deleted the qualifying phrase "of a financial, fiduciary or insurance nature" in Section 4(c)(8). Congress believed that this phrase was redundant. Its elimination was not intended to have any limiting effect on the scope of Section 4(c)(8). See H.R. Conf. Rep. No. 91-1747, *supra*, at 14-15; S. Rep. No. 91-1084, *supra*, at 15.

nevertheless be engaged in by bank-holding companies or their non-banking affiliates.

[Senator] Sparkman. The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions, of course, but I can assure you that we did not mean to enlarge or contract them here.* We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. The provision to which you referred is already complicated enough. *In short, we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank holding companies or any of their affiliates, now contained in the Glass-Steagall Act.* If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation. I hope there is no longer any misconception on that point.

[Senator] Williams. *It is reassuring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so.*

By emphasizing that the 1970 amendments to the Bank Holding Company Act neither enlarged nor contracted existing Glass-Steagall Act prohibitions and exemptions, Senator Sparkman made clear that the amendments did not prohibit activities permissible under the Glass-Steagall Act. The import of

these views is that the permissibility of activities involving securities should be judged by the terms of the Glass-Steagall Act, not by an amorphous prohibition of "securities related" activities read into Section 4(c)(8).[43]

The legislative history of the 1970 amendments contains no evidence that Congress believed that organization and management of a closed-end investment company were activities inappropriate for a bank holding company. Services to investment companies were discussed in the Senate Report on the 1970 amendments, but that Report referred only to open-end investment companies and expressly disavowed any intention to prohibit the operation of such companies. See S. Rep. No. 91-1084, *supra*, at 15:

> [T]his provision is not intended to prejudice the rights of banks or bank holding companies or their affiliates to engage in such of these activities as may be permitted under existing law or which may become permissible under this legislation or under any future legislation. In particular, the language is not intended to inhibit

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[43] The court of appeals repeatedly states that the Bank Holding Company Act did not "cut back on the prohibitions against securities activities contained in the Glass-Steagall Act" (Pet. App. 39a, 32a). This is true, but it is equally true that it did not *enlarge* the prohibitions of the Glass-Steagall Act, as the colloquy between Senators Sparkman and Williams makes clear.

> * * * operating commingled or managing agency accounts (bank sponsored mutual funds) * * *.[44]

Thus, the Senate Committee believed that even open-end investment companies (mutual funds) might be managed by bank holding companies if permissible under the Glass-Steagall Act. These views apply with even greater force to closed-end investment companies, which issue securities only on an infrequent basis (see pages 24-27, *supra*).

Finally, as the court of appeals recognized (Pet. App. 39a-40a), a prohibition in the House version of Section 4(c)(8) that would have precluded the Board from permitting holding companies to engage in the issuance or underwriting of securities whether or not such securities were redeemable was stricken from the bill that was ultimately enacted. See 115 Cong.

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[44] In 1970, the permissibility of "bank sponsored mutual funds" under the Glass-Steagall Act was unsettled. The D.C. Circuit had approved operation of such funds. See *National Association of Securities Dealers* v. *SEC*, 420 F.2d 83 (1969). After the 1970 amendments to the Bank Holding Company Act were enacted, this Court reversed the D.C. Circuit's decision. *Investment Company Institute* v. *Camp*, *supra*. In light of the fact that existing judicial precedent in 1970 favored the operation of open-end investment companies (mutual funds) by banks, there is little basis for inferring that Congress believed that such activities were forbidden by the Glass-Steagall Act. There is certainly no basis for concluding that Congress believed that *closed-end* funds would infringe the Glass-Steagall Act. As previously noted (see page 26, *supra*), the Board has long interpreted the Glass-Steagall Act to permit affiliations between banking organizations and closed-end investment companies. See 12 C.F.R. 218.102, 218.104(d).

Rec. 33133, 33139 (1969).[45] This prohibition was part of the "negative laundry list" that the House believed should be adopted to confine the discretion of the Board. That restrictive approach to Section 4(c)(8) was rejected by the Conference Committee,[46] which left to the Board the task of delineating those activities closely related to banking[47] and adopted the Glass-Steagall Act as the standard for evaluating connections between commercial and investment banking institutions (see pages 48-50, *supra*).[48]

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[45] The court of appeals was of the view that the language in the House bill would have barred bank holding companies from "operation of closed-end investment companies" (Pet. App. 39a-40a). However, there is no evidence in the legislative history that the House so understood this phraseology, which describes investment banking activities and not fiduciary management services. Indeed, Representative Patman, an advocate of the "negative laundry list" approach, believed that the phraseology was aimed at the underwriting of "mutual fund" (open-end investment company) shares. See 115 Cong. Rec. 32897, 33135 (1969).

[46] The statement of the House managers accompanying the Conference Report does not address the permissibility of securities activities of bank holding companies. It contains no suggestion that standards other than those prescribed in the Glass-Steagall Act should be applied to such activities. See H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. (1970).

[47] In the words of Senator Sparkman: "We reached a decision [in conference] that the whole thing ought to be flexible, that it ought to be lodged in the hands of the Federal Reserve Board to carry out the guidelines we set." 116 Cong. Rec. 42429 (1970).

[48] The decision of the court of appeals places reliance on certain statements of Dr. Charls Walker (then Under Secretary of the Treasury) to the Senate Committee on Banking

In sum, the legislative history of the Bank Holding Company Act reiterates a continuing theme: delineation of activities closely related to banking is a function committed to the Board's expert judgment. Section 4(c)(8) was not intended to create a new prohibition against "securities related" activities of bank holding companies. Congress believed that the Bank Holding Company Act would not disturb the coverage of the Glass-Steagall Act "in any way." 116 Cong. Rec. 42430 (1970).

C. Organization and management of closed-end investment companies are activities "closely related" to the traditional fiduciary activities of commercial bank trust departments

1. Because the management of a closed-end investment company by a bank holding company is consis-

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and Currency. Dr. Walker indicated that bank affiliates should not manage "mutual funds" (*open-end* investment companies), although he believed that banks should be permitted to do so directly (see Pet. App. 41a-42a). However, as previously noted, the Senate Committee Report shows that its members did not accept Dr. Walker's assessment, concluding that bank holding company operation of mutual funds would be appropriate if permissible under the Glass-Steagall Act. See pages 50-51, *supra*. Moreover, Dr. Walker never suggested that bank affiliates should not operate *closed-end* investment companies.

The court of appeals states that the expression "mutual fund," as used by Dr. Walker, may refer to a closed-end investment company (Pet. App. 44a n.63). But nowhere in the legislative history of the 1970 amendments is there an indication that Congress or the witnesses who appeared before it used such a misnomer. See *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625 n.11: "A mutual fund is an open-end investment company."

tent with the Glass-Steagall Act (see pages 19-39, *supra*), the court of appeals should have upheld the Board's regulation and interpretive ruling under Section 4(c)(8) unless it concluded that such activities could not rationally be classified as "closely related" to banking. The court of appeals did not, however, analyze this question at all, and it suggested no basis for disagreeing with the Board's determination that the management activities here in issue are "so closely related to banking or managing or controlling banks as to be a proper incident thereto" (Pet. App. 81a, 83a).[49]

A business activity is properly viewed as "closely related" to banking if banks generally engage in that activity or if banks engage in activities that are similar. See, *e.g.*, *National Courier Association* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229, 1237 (D.C. Cir. 1975). Organization and management of a closed-end investment company are activities appropriate for a bank holding company within this standard. That conclusion is strongly supported by Section 4(c)(7) of the Act, which, as previously noted (see pages 42-43, *supra*), permits a bank holding company to control and manage an investment company subsidiary in addition to controlling and managing bank subsidiaries.

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[49] Respondent's challenge to the Board's regulation and ruling before the Board and the court of appeals rested on Sections 16 and 21 of the Glass-Steagall Act. Respondent never contended that, as a factual matter, the business of managing a closed-end investment company is not "closely related" to banking under Section 4(c)(8).

As the Board explained, bank trust departments have traditionally organized and managed large collective investment funds such as common trust funds and pooled employee benefit funds, which include the assets of corporations, pension plans, charitable organizations, and individuals. These are conventional fiduciary services. See Pet. App. 62a; *SEC Report on Investment Trusts and Investment Companies* (*Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies*), H.R. Doc. No. 476, 76th Cong., 2d Sess. 7-16, 25-26 (1939); 12 C.F.R. 9.18; A. 4-8, 17-22. It is evident that managing a closed-end investment company is "closely related" to such traditional services. Indeed, available statistics show that commercial banks and trust companies have, both before and after the enactment of the Glass-Steagall Act, sponsored and organized a significant number of closed-end investment companies. See *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 70 (Part 2), 76th Cong., 1st Sess. 57-58, 124 (Table 25) (1939). In 1929, commercial banks and trust companies sponsored closed-end investment companies with $71 million in assets; in 1935, commercial banks and trust companies sponsored closed-end investment companies with $78 million in assets.[50] Today, banking institutions provide

---

[50] Since the adoption of the Board's regulation and interpretive ruling in 1972, fully one-third of the major closed-end investment companies that were organized were organized by banking institutions. See Wiesenberger Investment Companies Service, *Investment Companies* 572-575, 596-610 (1979).

a broad spectrum of management services to investment companies. See *SEC Final Report on Bank Securities Activities* 146-148 (1977): "The extent to which the largest 115 banks and their affiliates provide investment management and advice to investment companies is shown [in an attached table]. The data show that slightly more than $2 billion in investment company assets receive some degree of advice from banks; $583.6 million of this amount represents investment company assets over which banks have sole investment authority." Accord, *SEC Institutional Investor Study Report*, H.R. Doc. No. 92-64 (Part 2), 92d Cong., 1st Sess. 162, 140 (1971).[51]

2. Although the court of appeals did not analyze the closeness of the relationship between banking and managing a closed-end investment company, it did refer to the possibility that permitting a bank holding company to manage a closed-end investment company could lead to an undue aggregation of economic power or to unsound banking practices. See Pet. App. 46a. However, those are not questions that can be addressed in the abstract. The Board screens each bank holding company application to determine whether the statutory criteria are satisfied. See note

---

[51] The Board's regulation applies only to closed-end investment companies that are registered under the Investment Company Act of 1940 (Pet. App. 80a), and thus does not suggest that closed-end investment companies managed by bank holding companies are exempt from the requirements of the Securities Act of 1933, 15 U.S.C. 77a, 77c(a)(2), or the Investment Company Act of 1940, 15 U.S.C. 80a-1, 80-3.

2, *supra*; see also 12 C.F.R. 225.4(b); *Board of Governors of the Federal Reserve System* v. *First Lincolnwood Corp., supra.* In passing on an application by a particular bank holding company to serve as an investment adviser, the Board must determine whether the public benefits likely to result from the performance of the activity by the particular applicant outweigh possible adverse effects, including "undue concentration of resources" and "unsound banking practices." Thus, the bare possibility of undue concentration of resources or unsound banking practices in a particular case does not undermine the Board's generic determination that management of a closed-end investment company is an activity closely related to the traditional fiduciary business of commercial banks.[52]

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[52] The Board is empowered to deny applications of bank holding companies proposing to serve as investment advisers if the proposed new activities threaten to result in "decreased or unfair competition" or "undue concentration of resources." 12 U.S.C. 1843(c)(8); 12 C.F.R. 225.4(b). The Board is also equipped to deal with unsound banking practices in bank holding companies and their subsidiaries. See 12 U.S.C. 1818(b)(1), (3); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3646.

The court of appeals suggests that management of a closed-end investment company might cause the subsidiary of the holding company to lend money indiscriminately to corporations issuing securities held in the advisee's investment portfolio or to deny credit to competitors of those companies (Pet. App. 45a). The court does not explain why the commercial department of a bank would behave in this way. Moreover, the same speculative hypothesis could be advanced whenever a bank holds securities as trustee or managing agent. The Board and the Comptroller of the Currency super-

Moreover, as the Antitrust Division of the Department of Justice pointed out during proceedings before the Board on its proposed regulation (A. 10-16), new entry by bank holding companies (operating within the restrictions of the Glass-Steagall Act) would have a significant pro-competitive effect in the investment advisory industry. The entry of bank holding companies and their non-bank subsidiaries into the investment advisory industry would produce important new options for the investing public. Bank holding companies serving as investment advisers have already organized a substantial number of new closed-end investment companies (see note 50, *supra*). Bank holding companies could also extend their services to previously existing investment companies that wish to change their investment advisers in an effort to improve their economic performance (see note 7, *supra*). Thus, far from impairing competition in the investment advisory industry, the entry of bank holding company advisers—subject to the Board's supervision to prevent anticompetitive practices and undue concentration of resources—will significantly increase actual and potential competition. See Note,

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vise national banks and holding companies to assure that conflicts of interest of this kind do not arise. The suggestion of the court of appeals that subsidiary banks might be tempted to disclose "confidential information about their depositors" (Pet. App. 45a) to investment adviser affiliates requires only brief comment. Such unethical conduct would be a breach of fiduciary duty in violation of state law as well as an unsound banking practice subject to correction by the federal bank regulatory agencies.

The Legality of Bank-Sponsored Investment Services, 84 Yale L.J. 1477, 1485 (1975).

3. The decisions of this Court establish that the Board's interpretations of the federal banking laws are entitled to judicial deference (see pages 37-39, *supra*). That basic principle applies both under the Glass-Steagall Act and the Bank Holding Company Act. As a consequence, a regulation promulgated by the Board which determines that a particular activity is "closely related to banking" should be upheld unless the Board's determination is arbitrary or capricious. See *National Courier Association* v. *Board of Governors of the Federal Reserve System*, *supra*, 516 F.2d at 1235-1237; *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors of the Federal Reserve System*, *supra*, 568 F.2d at 552; see also *Camp* v. *Pitts*, 411 U.S. 138, 140-142 (1973).

The Board's determination that organization and management of a closed-end investment company is an activity closely related to banking and therefore is permissible for a bank holding company is not an arbitrary or capricious determination. As we have shown, nothing in the text or history of the Bank Holding Company Act or the Glass-Steagall Act precludes that determination. Under these circumstances, the court of appeals should have upheld the Board's regulation and interpretive ruling.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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MAY 1980

APPENDIX

1. Section 2(b) of the Glass-Steagall Act, 12 U.S.C. 221a(b), provides in pertinent part:

> Except where otherwise specifically provided, the term "affiliate" shall include any corporation, business trust, association, or other similar organization—
>
> * * * * *
>
> (2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank * * *
>
> * * * * *
>
> (4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

2. Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, provides in pertinent part:

> * * * The business of dealing in securities and stock by the [national banking] association shall

be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock * * *.

3. Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, provides in pertinent part:

> After one year from June 16, 1933, no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities: * * *.

4. Section 21(a)(1) of the Glass-Steagall Act, 12 U.S.C. 378(a)(1), provides in pertinent part:

> After the expiration of one year after June 16, 1933, it shall be unlawful
>
> * * * * *
>
> For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor * * *.

5. Prior to its repeal in 1966, Section 19 of the Glass-Steagall Act, ch. 89, 48 Stat. 186-188, 12 U.S.C. (1964 ed.) 61, provided in pertinent part:

> * * * For the purposes of this section * * * [national bank] shares shall be deemed to be controlled by a holding company affiliate if they are owned or controlled directly or indirectly by such holding company affiliate, or held by any trustee for the benefit of the shareholders or members thereof.
>
> Any such holding company affiliate may make application to the Board of Governors of the Federal Reserve System for a voting permit entitling it to vote the stock controlled by it * * *. The Board of Governors of the Federal Reserve System may, in its discretion, grant or withhold such permit as the public interest may require * * * but no such permit shall be granted except upon the following conditions:
>
> * * * * *
>
> (e) Every such holding company affiliate shall, in its application for such voting permit, (1) show that it does not own, control, or have any interest in, and is not participating in the management or direction of, any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, floatation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort (hereinafter referred to as "securities company"); (2) agree that during the period

that the permit remains in force it will not acquire any ownership, control, or interest in any such securities company or participate in the management or direction thereof; (3) agree that if, at the time of filing the application for such permit, it owns, controls, or has an interest in, or is participating in the management or direction of, any such securities company, it will, within five years after the filing of such application, divest itself of its ownership, control, and interest in such securities company and will cease participating in the management or direction thereof, and will not thereafter, during the period that the permit remains in force, acquire any further ownership, control, or interest in any such securities company or participate in the management or direction thereof * * *.

6. Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), provides in pertinent part:

> Except as otherwise provided in this Act, no bank holding company shall—
>
> > (1) after May 9, 1956 acquire direct or indirect ownership or control of any voting shares of any company which is not a bank * * *.

7. Section 4(c) of the Bank Holding Company Act, 12 U.S.C. 1843(c), provides in pertinent part:

> The prohibitions in this section shall not apply to
>
> * * * * *
>
> > (7) shares of an investment company which is not a bank holding company and

which is not engaged in any business other than investing in securities, which securities do not include more than 5 per centum of the outstanding voting shares of any company;

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern;

* * * * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, *Petitioner*

v.

INVESTMENT COMPANY INSTITUTE, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

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On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF FOR THE RESPONDENT

COUNTERSTATEMENT OF THE QUESTION PRESENTED

Whether the Glass-Steagall Act, as construed by this Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), and the Bank Holding Company Act, as amended, forbid the Federal Reserve Board to authorize banks and their holding company affiliates to sponsor closed-end investment companies as vehicles for the issuance and marketing of securities to the general public.

COUNTERSTATEMENT OF THE CASE

Introductory Statement

This case presents the latest effort in a 20-year campaign by segments of the United States banking industry, often aided by its federal regulators, to gain access to a line of business from which banks and their affiliates were excluded by an act of Congress nearly half a century ago—the sponsorship, organization, management, and control of investment companies as vehicles for the marketing of securities to the general public.

The Camp Decision

On April 5, 1971, in *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971), this Court concluded that the Banking Act of 1933, popularly known as the Glass-Steagall Act, precludes national banks from sponsoring investment companies—that is, companies set up as investment vehicles to offer their own securities to the general public and to use the proceeds to purchase securities for their portfolios. Overturning a 1962 regulation of the Comptroller of the Currency that purported to authorize such activity, the Court ruled that a bank's "operation of an investment fund of the kind approved by the Comptroller involves [the] bank in the underwriting, issuing, selling, and distributing of securities in violation of §§ 16 and 21 of the Glass-Steagall Act." 401 U.S. at 639.

The Court's ruling in *Camp* was based upon a thorough review of the legislative history of the Glass-Steagall Act, and in particular the congressional determination to divorce commercial banking on the one hand from the issuance and marketing of securities on the other in light of the banking crisis of the early

1930s that had been brought on in large measure by the intertwining of those two lines of commerce.

The Board's Proposed Regulation

Fewer than five months after the *Camp* decision, on August 12, 1971, the petitioner, Board of Governors of the Federal Reserve System (hereafter the "Board") proposed an amendment to its Regulation Y, purportedly promulgated under the Bank Holding Company Act Amendments of 1970. Specifically, the Board announced that it proposed to amend Section 222.4(a) of Regulation Y to permit bank holding companies to serve as investment advisers to investment companies.[1]

In response to the Board's notice, the Investment Company Institute (the "Institute"), a trade association of investment companies, submitted several memoranda and the affidavit of its president in opposition to the proposed amendment (R. 7-63).

The Final Regulation and Interpretive Ruling

On January 28, 1972, following an informal hearing, the Board promulgated the final version of its amend-

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[1] The text of the proposed amendment read pertinently:

"§ 222.4 *Nonbanking Activities.*

"(a) ***Activities closely related to banking or managing or controlling banks.*** * * * The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

* * *

"(5) Acting as investment or financial adviser, including (i) serving as the advisory company for a mortgage or a real estate investment trust; (ii) ***serving as investment adviser to an investment company registered under the Investment Company Act of 1940;*** and (iii) furnishing economic or financial information." 36 Fed. Reg. 16695 (Aug. 25, 1971), as amended, 36 Fed. Reg. 17514 (Sept. 1, 1971) (Pet. App. 4a) (emphasis supplied).

ment to Regulation Y.[2] Accompanying the revised Regulation Y was an Interpretive Ruling of the Board, published at 37 Fed. Reg. 1464 (1972), relating to the scope of the activity described in the regulation (Pet. App. 83a). The Interpretive Ruling itself was codified as Section 225.125 of Regulation Y (12 C.F.R. § 225.125).

At the outset, the Board conceded that "it is clear from the legislative history of the Bank Holding Company Act Amendments of 1970 . . . that the Glass-Steagall Act provisions were not intended to be affected thereby." Accordingly, the Board stated that it regarded "the Glass-Steagall provisions and the Board's prior interpretations thereof as applicable to a holding company's activities as an investment adviser." Section 225.125(b).

The Board then declared that under its revised regulation, bank holding companies were defined to include "*both their bank* and nonbank *subsidiaries*" (emphasis supplied). As so defined, such holding companies were authorized by the Board to "act as investment advisers to *various types* of investment com-

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[2] That amen nent, in pertinent part, revised the operative provision in Section 225.4(a)(5)(ii) (the underscored material in footnote 1 above) to read as follows:

> "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company under that Act . . . ." 37 Fed. Reg. 1463; 12 C.F.R. § 225.4(a)(5)(ii) (Pet. App. 81a).

The effect of the Board's revision, incorporating the provision of the 1940 Act referred to, was to bring into play that Act's definition of an "investment adviser" as any person who, pursuant to contract with the investment company, regularly furnishes investment advice, or has the power to make determinations with respect to portfolio purchases and sales. 15 U.S.C. § 80a-2(a)(20).

panies" (emphasis supplied), including both open-end investment companies, commonly referred to as mutual funds, and closed-end investment companies. Section 225.125(c).

The Board next announced its view that "a bank holding company may exercise all functions that are permitted to be exercised by an 'investment adviser' under the Investment Company Act of 1940 . . . ." Section 225.125(d). The Board acknowledged that, as a matter of industry custom and practice, investment advisers to investment companies registered under the Investment Company Act do far more than merely advise their investment companies as to portfolio purchases and sales. Rather, the Board recognized, "presently most mutual funds are organized, sponsored and managed by investment advisers with which they are affiliated and . . . their securities are distributed to the public by such affiliated investment advisers, or subsidiaries or affiliates thereof." Section 225.125(e).

The Board stated its opinion that "the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund"—that is, an *open*-end investment company. Section 225.125(f). However, the Board stated its disbelief that "such restrictions apply to closed-end investment companies as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities." *Id.* The Board thereupon proposed a series of restrictions upon bank holding company sponsorship, organization, and control of closed-end investment companies which, in its view, would enable participating entities to avoid a violation of Glass-Steagall.

Taken as a whole, the Board's Regulation and accompanying Interpretive Ruling sanctioned a wide degree of involvement on the part of bank holding companies and their subsidiaries in virtually all phases of closed-end investment company activities—the organization of the funds, their management, discretionary control of their portfolio purchases and sales, and (except as restricted in the Interpretive Ruling) their marketing and promotion. In its Ruling, the Board referred to the practice of the investment company industry whereby the fund adviser conventionally organizes, sponsors, and manages the fund with which it is affiliated. Section 225.125(e); *cf.* A. 13-15 (submission of Justice Department). The court of appeals below spoke of the "sponsoring, organizing, managing, or controlling [of] such companies." *Investment Company Institute* v. *Board of Governors of the Federal Reserve System,* 606 F.2d 1004, 1009 n.13 (Pet. App. 8a). Before this Court, the Board has characterized its Regulation and Interpretive Ruling as leaving the bank holding company "free to organize and manage the client investment company, to select its investments, and to provide ancillary services" (Pet. Br. 29 n.21). In this Brief, we shall refer collectively to all such activities sanctioned by the Board as the "sponsorship" of the investment company, which it is apparent that the Board has intended to authorize to bank holding companies and their subsidiaries, banking and nonbanking alike.

The Institute's First Petition

On December 12, 1973, the Institute petitioned the Board to reconsider and rescind the Regulation. An affidavit submitted in support of the petition demon-

strated that as of its date, at least 16 closed-end investment companies were organized, controlled and advised by banks and bank-affiliated institutions, and that of those 16, at least 10 were advised by the *banks* affiliated with the holding companies concerned (R. 338-50). A number of sponsoring banks specifically referred to the Regulation as authorizing their sponsorship of closed-end investment companies. *See* pp. 14-15 *infra.*

On March 8, 1974, the Board denied the Institute's petition in a letter addressed to the Institute's counsel (Pet. App. 53a). *First,* the Board rejected the Institute's contention that the Regulation sanctioned activity in violation of Glass-Steagall Act Section 21. The Board asserted that "the prohibitions of Section 21 apply only to a bank and may not be held applicable to a bank holding company or a nonbank subsidiary of a bank holding company" (Pet. App. 56a).

Second, the Board conceded that "some of the same dangers cited by the United States Supreme Court in *ICI* v. *Camp* . . . may also be present with respect to the conduct of investment advisory activities" (Pet. App. 57a). However, the Board purported to discover "several significant distinctions" between the investment fund that this Court had found unlawful in *Camp* and the activity authorized by the amended Regulation Y. The Board's distinction turned essentially upon the asserted facts that under the Regulation bank holding companies were prohibited to engage in the actual offering and sale of investment company securities, and further that closed-end funds generally are characterized by an absence of continuous selling activity.

Third, the Board denied that its Regulation authorized bank sponsorship of investment companies in violation of Glass-Steagall Section 16. Here the Board asserted that its definition of "bank holding company" to include banking as well as nonbanking subsidiaries amounted to a restriction upon the grant of authority contained in the revised Regulation, and that the authorizations set forth in the accompanying Interpretive Ruling "were only intended to apply where the investment advisory function was being conducted by a nonbanking subsidiary of the bank holding company" (Pet. App. 61a). Thus, the Board concluded, any bank sponsorship of an investment company purportedly in reliance upon the Regulation and Interpretive Ruling could not in fact be activity pursuant to the Regulation. *Id.* Nonetheless, as the primary federal supervisory agency for state member banks of the Federal Reserve System, the Board specifically held that, consistently with Glass-Steagall, a bank could purchase securities for investment funds that it sponsored, on the theory that an investment company created and controlled by the bank could be deemed its "customer" within the meaning of Glass-Steagall Section 16 (Pet. App. 62a-63a).

On May 8, 1974, the Institute commenced a civil action against the Board and its individual members in the United States District Court for the District of Columbia. The Institute's complaint sought a declaratory judgment and injunctive and other relief. Various evidentiary materials, including affidavits, were received by the district court in connection with cross-motions for summary judgment.

On July 30, 1975, the district court entered an order dismissing the complaint on the ground that review of

the Board's action properly should be sought in the first instance in the court of appeals pursuant to Section 9 of the Bank Holding Company Act. *Investment Company Institute* v. *Board of Governors of the Federal Reserve System,* 398 F. Supp. 725 (D.D.C. 1975). On January 14, 1977, the United States Court of Appeals for the District of Columbia Circuit affirmed the district court's jurisdictional ruling. However, the court of appeals granted leave to the Institute to file a fresh petition for reconsideration before the Board and to prosecute a petition for review in an appropriate court of appeals should the Board deny that petition. *Investment Company Institute* v. *Board of Governors of the Federal Reserve System,* 551 F.2d 1270 (1977).

The Institute's Second Petition

On March 18, 1977, the Institute filed a renewed petition before the Board in accordance with the decision of the court of appeals, requesting that the Board reconsider and rescind the Regulation (R. 2696). The renewed petition incorporated by reference the evidentiary materials submitted in support of the first petition, and offered supplemental evidence by affidavit. In the aggregate, those evidentiary materials demonstrated the active involvement of both banks and bank affiliates in the sponsorship of investment companies, as well as the participation of such banking institutions in the underwriting and public sale of the securities issued by investment companies.

On August 31, 1977, the Board by order denied the Institute's renewed petition (Pet. App. 65a). Again, the Board refused to consider the Institute's evidentiary showing that banks, as well as bank holding

companies and nonbanking affiliates, were engaged in the sponsorship of investment companies, on the purported ground that such conduct could not be deemed sanctioned by the Board's Regulation (Pet. App. 67a-68a).

On September 23, 1977, the Institute initiated the present judicial proceeding by filing a petition for review before the United States Court of Appeals for the District of Columbia Circuit. By judgment entered March 30, 1979, that court vacated the Regulation and Interpretive Ruling. 606 F.2d 1004 (Pet. App. 50a). After rejecting the Board's threshold challenge to the standing of the Institute to maintain the petition for review, 606 F.2d at 1010-11 (Pet. App. 12a-14a), the court analyzed the applicable statutory schemes. The court concluded that it was unnecessary to determine whether any particular provision of the Glass-Steagall Act operated to invalidate the Regulation and Interpretive Ruling. In the court's view, the Bank Holding Company Act, as amended, pursuant to which the Board purportedly had acted, did not authorize the promulgation of the Regulation and Interpretive Ruling under attack.

The Board petitioned for rehearing and suggested a rehearing *en banc*. After the court of appeals denied those applications (Pet. App. 51a), the present petition for certiorari followed.

SUMMARY OF ARGUMENT

I.

The Regulation promulgated by the Board, together with its Interpretive Ruling, violates the prohibition of the Glass-Steagall Act against the involvement of

the banking industry in the issuance and marketing of securities to the general public. The Regulation and Interpretive Ruling permit the sponsorship by banks of closed-end investment companies, despite the plain prohibition contained in Sections 16 and 21 of the Glass-Steagall Act, as interpreted by this Court in *Investment Company Institute* v. *Camp, supra.* The evidence submitted by the Institute to the Board below demonstrated that banks in fact are relying upon the Regulation and Interpretive Ruling to engage in the prohibited activities.

The ostensible justification offered by the Board for its departure from *Camp*—that that case dealt only with the equivalent of an open-end fund, whereas here the Board has permitted bank involvement in closed-end funds—is without material significance. The functional similarities of closed- and open-end funds outweigh their differences, and the prohibitions contained in Glass-Steagall plainly apply to investment companies of both categories.

II.

The Bank Holding Company Act, as amended, provides no statutory authority to the Board to authorize activities by bank holding companies that are prohibited to banks by the Glass-Steagall Act. Neither the Bank Holding Company Act of 1956, nor the 1966 and 1970 amendments to that Act, have displaced the fundamental statutory bar erected by Glass-Steagall to the banking industry's involvement in securities issuance and marketing. The legislative history of the 1970 amendments to the Bank Holding Company Act makes clear that Congress never contemplated that the Board would have the authority to find that the

sponsorship of closed-end investment companies is a function, in the words of the statute, "so closely related to banking . . . as to be a proper incident thereto . . . ."

As a matter of law, bank holding company sponsorship of closed-end investment companies cannot meet the test prescribed by the Bank Holding Company Act. *First,* because such sponsorship affirmatively is prohibited to banks under Glass-Steagall, it cannot be deemed "a proper incident" of banking for purposes of the Bank Holding Company amendments. *Second,* because the sponsorship of closed-end investment companies would depart from accepted and traditionally circumscribed fiduciary functions of banks, as recognized by the Board in numerous past rulings, such sponsorship likewise cannot be deemed "a proper incident" within the meaning of the 1970 amendments.

III.

The Regulation and Interpretive Ruling are invalid insofar as they authorize the sponsorship of closed-end investment companies by bank holding companies. As in the case of banks, such sponsorship violates the Glass-Steagall Act, as is apparent from a review of the overall statutory scheme and of the particular statutory provisions that relate to bank affiliate involvement in securities marketing. The abstinence of the banking industry from the sponsorship of investment companies in the years following enactment of Glass-Steagall demonstrates the industry's awareness that the Act effectively foreclosed securities flotation and distribution as a line of commerce for both banks and their holding company affiliates.

The Board purports to recognize the import of Glass-Steagall and this Court's interpretation in *Camp,* but its Regulation and Interpretive Ruling do little more than pay lip service to those principles. The Ruling, which ostensibly narrows the scope of permitted activity by bank holding companies in their sponsorship of closed-end investment companies, disregards Congress' intention in Glass-Steagall to fashion a prophylactic statute that would leave no room for the exercise of administrative discretion. The Ruling also fails to address many of the central concerns that were voiced both by the authors of Glass-Steagall at the time of its enactment and by this Court in *Camp* when it reviewed the history of that legislation.

ARGUMENT

I. THE BOARD'S REGULATION AND INTERPRETIVE RULING VIOLATE THE GLASS-STEAGALL ACT IN THAT THEY PURPORT TO SANCTION BANK SPONSORSHIP OF CLOSED-END INVESTMENT COMPANIES

A. The Regulation and Interpretive Ruling Permit Bank Sponsorship of Investment Companies

On their face, the Board's Regulation and Interpretive Ruling purport to authorize banks, as well as bank holding companies and their nonbank subsidiaries, to sponsor closed-end investment companies. The Interpretive Ruling states that the term "bank holding companies" includes "both their *bank* and non-bank subsidiaries," 12 C.F.R. § 225.125(c) (emphasis supplied); that "the Glass-Steagall Act provisions, as interpreted by the U.S. Supreme Court, forbid a bank holding company to sponsor, organize or control a mutual fund," *id.* § 225.125(f); but that "the Board

does not believe that such restrictions apply to closed-end investment companies," *id.* The plain meaning of the Interpretive Ruling is that both banks, on the one hand, and bank holding companies and nonbank subsidiaries, on the other, may engage in the sponsorship of closed-end funds. The Board has confirmed this interpretation of its Ruling by its March 8, 1974 ruling denying the Institute's petition for reconsideration and rescission. There, in its role as supervisory agency for state member banks, the Board specifically concluded that banks may sponsor closed-end funds.

The banking industry has taken the Board at its word. Following promulgation of the Regulation and Ruling, numerous national and state banks, for the first time since the passage of Glass-Steagall, began to involve themselves in the organization and operation of closed-end investment companies. Less than a month after promulgation of the Regulation, Independence Square Income Securities, Inc., one of the investment companies advised directly by Provident National Bank (Philadelphia) stated in its prospectus: "To the knowledge of Provident, the Fund will be the first closed-end investment company, the securities of which are publicly traded, for which a national bank acts as investment adviser" (R. 2420).

The banks acted in direct reliance upon the Board's Regulation. This is evident from the registration statements filed with the SEC by a number of the closed-end investment companies advised directly by banks. A good example appears in the prospectus filed in 1972 by Advance Investors Corporation, a closed-end fund sponsored and managed directly by Citibank

(which earlier had sponsored the fund condemned in *Camp*):

> "In May 1971 the United States Supreme Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, held that the Glass-Steagall Act prohibits a national bank from operating a fund for the collective investment of managing agency accounts. The fund which was the subject of the litigation was operated by Citibank and was registered as an open-end investment company. . . . Subsequent to such decision, the Board of Governors of the Federal Reserve System ruled that the Glass-Steagall Act and such decision do not prohibit a bank holding company *or any subsidiary* thereof from acting as investment adviser to a registered, closed-end investment company. Citibank is a subsidiary of First National City Corporation, which is a bank holding company registered under the Bank Holding Company Act, and *accordingly Citibank is within the terms of the Board's ruling*" (R. 2305) (emphasis supplied).[3]

Bank activities with respect to closed-end investment companies hardly have been confined to the rendition of

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[3] Similar statements relying upon the Board's Ruling as authority for banks within a bank holding company complex to serve as investment advisers to closed-end investment companies may be found in the S-4 Registration Statements of the following funds: Ben Franklin Income Securities, Inc. (R. 418), advised by Girard Trust Bank (Philadelphia); Bunker Hill Income Securities, Inc. (R. 469), advised by Security Pacific National Bank (Los Angeles); Circle Income Shares, Inc. (R. 666), advised by American Fletcher National Bank & Trust Company (Indianapolis); Overland Income Securities, Inc. (R. 1660), advised by Wells Fargo Bank, National Association (San Francisco); and Pacific American Income Shares, Inc. (R. 1767), advised by a subsidiary of United California Bank.

investment advice to closed-end investment companies. To the contrary, in their sponsorship of closed-end funds, banks have gone to the limit of the apparent authorization contained in the Ruling. In Appendix A to this Brief, we outline the record evidence that demonstrates the pervasive involvement of banks in the sponsorship and management of closed-end funds in reliance on the Board's ruling.

Since the issuance of its Ruling, the Board steadfastly has disclaimed any intention to *authorize* activities to banks under its Ruling. By means of a strained construction of its edict, the Board asserts that the definition of "bank holding company" under its Ruling serves only as a "short-hand method" to impose the *restrictions* of that Ruling upon bank subsidiaries of bank holding companies. Such a position is inconsistent with the Board's March 8, 1974 letter to the Institute. There, in its capacity as federal regulatory supervisor of state member banks, the Board opined that banks lawfully may undertake the activities authorized to holding companies in the Regulation (Pet. App. 61a-63a).

The court of appeals understandably was dubious about the Board's disclaimer of any intention to authorize activities to banks. The court said:

> "Although the Board's explanation of the interpretive ruling is reasonable, it is nevertheless true that *the ruling is highly susceptible to the construction urged by* [*the Institute*]. While that ruling has been published in the Federal Register and the Code of Federal Regulations, the Board's disclaimer has, so far as we know, been circulated only to [the Institute] . . . and to other persons who may have had occasion to read that letter or

> the Board's brief in this review proceeding." 606 F.2d at 1014 (Pet. App. 23a) (emphasis supplied).

Because the court ultimately vacated the Regulation and Ruling on other grounds, it had no occasion to consider what relief might be appropriate to deal with the ambiguity in the Board's draftsmanship.

The banking industry has responded in full measure to the Board's invitation to the industry to immerse itself in the securities business. The 1979 edition of Wiesenberger Investment Companies Service shows the following currently operating closed-end investment companies which were created and sponsored by banking institutions following the Board's Ruling:

Name of Investment Company and Year Organized	Investment Adviser	
Bunker Hill Income Securities, Inc. (1973)	Bank	Security Pacific National Bank, a wholly-owned subsidiary of Security Pacific Corp.
Circle Income Shares, Inc. (1973)	Bank	American Fletcher Nat'l Bank & Trust Co., wholly-owned by American Fletcher Corp.
Current Income Shares, Inc. (1973)	Nonbank subsidiary	Unionamerica Investment Management Co., a wholly-owned subsidiary of Unionamerica, Inc.
Excelsior Income Shares, Inc. (1973)	Bank subsidiary	UST Advisory Co., Inc., a wholly-owned subsidiary of United States Trust Co. of N.Y.
Fort Dearborn Income Securities, Inc. (1972)	Bank	First National Bank of Chicago, a wholly-owned subsidiary of First Chicago Corp.

Name of Investment Company and Year Organized	Investment Adviser	
Hatteras Income Securities (1973)	Bank	N. Carolina National Bank, a wholly-owned subsidiary of N.C.N.B. Corp.
Independence Square Income Securities, Inc. (1972)	Bank	Provident Nat'l Bank, a wholly-owned subsidiary of Provident Nat'l Corp.
Montgomery Street Income Securities (1973)	Nonbank subsidiary	B.A. Investment Mgmt. Corp., a wholly-owned subsidiary of Bank America Corporation
Pacific American Income Shares (1973)	Bank subsidiary	Western Asset Mgmt. Co., a wholly-owned subsidiary of United California Bank, a wholly-owned subsidiary of Western Bancorporation
Vestaur Securities Inc. (1972)	Nonbank subsidiary	First Pennsylvania Corporation, whose principal subsidiary is The First Pennsylvania Banking & Trust Co.

Significantly, five of the 10 investment advisers are *banks,* not their holding companies or other nonbanking affiliates. So far as we are aware, neither the Board nor the Comptroller of the Currency has undertaken enforcement proceedings or opened administrative investigations as to any of the five banks.

B. The Board's Authorization of Bank Sponsorship of Closed-End Investment Companies Violates Sections 16 and 21 of the Glass-Steagall Act as Authoritatively Construed by This Court in Camp

In *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971), this Court held that Sections 16 and 21 of the Glass-Steagall Act prohibit banks from creating

and operating investment companies. Contrary to the Board's present suggestion (Pet. Br. 31-37), the Court's ruling was not narrowly confined to the lawfulness of bank-sponsored *open*-end funds. Rather, the question before the Court was the lawfulness of *all* bank-sponsored funds, closed- as well as open-end:

> "The issue before us is whether the Comptroller of the Currency may, consistently with the banking laws, authorize a national bank to offer its customers the opportunity to invest in a *stock fund created and maintained by the bank.*" 401 U.S. at 621 (emphasis supplied).

Analysis of the *Camp* decision shows that the Court there precluded what the Board's Regulation and Ruling purport to authorize here—bank sponsorship of closed-end investment companies.

The entity at issue in *Camp* was a plan for the collective investment of managing agency accounts initiated by First National City Bank of New York (now known as Citibank, N.A.). Under the plan a bank customer tendered between $10,000 and $500,000, along with an authorization to the bank to act as the customer's managing agent. In return, the customer received written evidence of his interest in the fund, expressed in "units of participation." The participation units were freely redeemable, as well as transferable to any other person who had executed a managing agency agreement with the bank. The fund was registered under the Investment Company Act of 1940, and the bank served as the fund's underwriter within the meaning of that Act. Additionally, the fund filed a registration statement pursuant to the Securities Act of 1933. The bank exercised full custody of and investment authority over the fund as investment adviser

pursuant to a management agreement. 401 U.S. at 622-23.

As authority for its creation and operation of the fund, Citibank relied upon an approval that it had obtained from the Comptroller of the Currency pursuant to a regulation promulgated by the Comptroller in 1962 under 12 U.S.C. § 92a. The Court held that regulation invalid. It recognized that national banks traditionally had enjoyed the power to commingle trust funds on the one hand and to act as managing agent on the other. However, the Court held that the union of those powers in the case of the bank-sponsored fund simultaneously violated the prohibitions of Sections 16 and 21 of the Glass-Steagall Act.

In reaching its conclusion, the Court emphasized the history of the ill-fated securities affiliates of commercial banks and the congressional objective reflected in Glass-Steagall to separate commercial banking from securities issuance and marketing. The Court noted that at the time of enactment of Glass-Steagall, the failure of the Bank of the United States in 1930 was attributed to the bank's activities in connection with its numerous securities affiliates. 401 U.S. at 629. Congress was "concerned that commercial banks . . . had both aggravated and been damaged by the stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities." *Id.* at 630. Thus, Congress' prophylactic goal was to prevent

> "hazards that arise when a commercial bank goes beyond the business of acting as fiduciary or managing agent and enters the investment banking business either directly or by establishing an affiliate to hold and sell particular investments." 401 U.S. at 630.

The Court stressed that Glass-Steagall was a "prophylactic measure." 401 U.S. at 639. Congress had elected broadly to prohibit activities that had demonstrated potentials for abuse, rather than to attempt to outlaw only the "hazards" so as to enjoy the benefits supposedly attendant upon "competition, convenience, or expertise which might otherwise support the entry of commercial banks into the investment banking business." *Id.* at 630. Congress sought to avoid the promotional pressures to which commercial banks inevitably would become subject once they went beyond "purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers" (Glass-Steagall Section 16) and engaged, even to a limited extent, in "issuing, underwriting, selling, or distributing" securities (Section 21).

Promotional incentives created the likelihood that banks would take measures to support their sponsored investment entities inconsistent with the interests of the banks' depositors. Thus, a commercial bank would be tempted, among other things, to "make its credit facilities more freely available to those companies in whose stock or securities the affiliate has invested or become otherwise involved," and to render less than "disinterested investment advice" to customers. 401 U.S. at 631-33. In general, the Court said,

> "Congress feared that the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence and restraint to the enterprise of selling particular stocks and securities, and that this could not be done without that reputation being undercut by the risks necessarily incident to the investment banking business." 401 U.S. at 632.

The Court concluded that the "same hazards are clearly present when a bank undertakes to operate an investment fund." 401 U.S. at 636. It noted that a "bank that operates an investment fund has a particular investment to sell." *Id.* Unless the bank could generate public interest in fund participations as compared to other investments, the size of the fund, and the bank's fee, would suffer. Promotional pressures would be generated by competition with nonbank investment funds. Thus, the "bank would have a salesman's stake in the performance of the fund, for if the fund were less successful than the competition the bank would lose business and the resulting fees." *Id.* at 636-37. Significantly,

> "A bank that operated an investment fund would necessarily put its reputation and facilities squarely behind that fund and the investment opportunity that the fund offered. The investments of the fund might be conservative or speculative, but in any event the success or failure of the fund would be a matter of public record. Imprudent or unsuccessful management of the bank's investment fund could bring about a perhaps unjustified loss of public confidence in the bank itself." *Id.* at 637.

In addition, the Court observed that the other hazards against which Glass-Steagall was directed are present where a bank creates and operates an investment fund—for example, the risks that the bank might make unsound loans or lend other assistance to the fund or the companies in which the fund invested, or exploit its confidential relationships with its commercial and industrial creditors for the benefit of the fund, or pursue other avenues to support the fund inconsistent with the interests of its depositors. *See* 401 U.S. at 637-38.

In sum, the Court concluded that the bank-sponsored investment activity before it "involve[d the] bank in the underwriting, issuing, selling, and distributing of securities in violation of §§ 16 and 21 of the Glass-Steagall Act." 401 U.S. at 639. At no point did the Court suggest that its reasoning as outlined above was narrowly confined to open-end funds, nor is there any basis to suggest that the Court's reading of Glass-Steagall should be so limited.

C. The Distinction Sought To Be Drawn Between Open-End and Closed-End Investment Companies Is Untenable

In its Regulation and accompanying Interpretive Ruling, the Board has purported to recognize the controlling authority of this Court's *Camp* decision. At the same time, however, the Board seeks to cut back on the reach of *Camp* by seizing upon the happenstance that the investment fund there under consideration was of an open-end variety. The Board has hit upon a non-distinguishing feature of the case. The Court's decision in *Camp* did not turn upon the difference between open- and closed-end funds. To the contrary, the Court there spoke of the hazards of bank creation and operation of "investment funds" generally—a term that plainly encompasses closed- as well as open-end funds. *See, e.g.*, 401 U.S. at 634-38.

The language of Glass-Steagall, its relevant history, and the policies underlying its enactment as identified in *Camp* do not allow any such differentiation as that which the Board has sought to create here.

1. *Glass-Steagall Sections 16 and 21 Independently Bar Banks from Sponsoring Closed-End Investment Companies*

On their face, Glass-Steagall Sections 16 and 21 prohibit the association of a bank with the initial issuance, underwriting, sale, and distribution of the securities of *any* investment fund sponsored by the bank, as well as the subsequent portfolio transactions for any such fund, whether open- or closed-end.

Section 16, as supplemented by Section 5(c), Fifth, provides pertinently:

> "The business of dealing in investment securities by [any national or state member bank in the Federal Reserve System] shall be limited to purchasing and selling such securities without recourse, *solely upon the order, and for the account of, customers, and in no case for its own account, and the* [*member bank*] *shall not underwrite any issue of securities* . . . ." 48 Stat. 184 (emphasis supplied).[4]

By its terms, the Section prohibits member banks from underwriting securities. Further, banks may purchase and sell securities "solely upon the order, and for the account of, customers." Thus, bank sponsorship of *any* investment company (whether closed- or open-end) that issues securities for distribution and sale to the general public is squarely prohibited.

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[4] Under Section 16, as enacted in 1933, "investment securities" were narrowly limited to debt instruments. Thus, the Section granted no authority to banks to purchase stock even for the account of customers, and it prohibited any purchase of stock by banks for their own account. The 1935 amendments to the National Banking Act clarified that a national bank could buy stock for the account of customers, but not for its own account. 49 Stat. 709; *cf.* S. Rep. No. 1007, 74th Cong., 1st Sess. 17 (1935); H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935); *cf. Camp, supra,* at 623-24 n.10.

The legislative history establishes that Section 16 was intended to permit banks to purchase and sell investment securities only at the request, and for the account and convenience, of existing customers. S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933). That view was confirmed by the Comptroller of the Currency in 1936 in the following description of the effect of the Section:

> "In general this clause confines the activity of a national bank in purchasing and selling securities for the accounts of customers to that of an accommodation agent, *the purpose being to prevent such banks from engaging in the business of dealing in securities for profit,* without limiting the service which may be rendered to customers in purchasing and selling securities upon their orders and for their accounts . . . ." Bulletin, Comptroller of the Currency ¶ 35 (Oct. 26, 1936) (emphasis supplied).

There is no suggestion, either in the legislative history or in any subsequent interpretation of Section 16, that the provision somehow contains an exception authorizing member banks to purchase and sell securities for profit on any basis other than "solely upon the order, and for the account of, customers." That history intimates no exception for investment companies at all, let alone for closed-end funds.

Contrary to the Board's suggestion in its March 8, 1974 ruling (Pet. App. 53a), a bank cannot avoid the restrictions of Section 16 by the simple device of creating and managing its own "customers." In *Camp,* this Court rejected the argument that banks should be permitted to engage in securities transactions on behalf of sponsored investment companies on the theory that such activities somehow were akin to activities for the accounts of *bona fide* customers. *See* 401 U.S. at 634-38.

Section 21 of Glass-Steagall provides pertinently:

> "[I]t shall be unlawful . . . [f]or *any* person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, *selling, or distributing* . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time *to any extent whatever* in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor . . . ." 48 Stat. 189 (emphasis supplied).

By its terms, this Section prohibits *any* enterprise from engaging simultaneously in two specified lines of commerce—(i) "issuing, underwriting, selling, or distributing . . . securities"; and (ii) commercial banking, *i.e.*, "receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor." Section 21 thus forces every enterprise, no matter how denominated, to a choice. It may engage either in commercial banking; or it may engage in the business of issuing, underwriting, selling, or distributing securities. It may not do both.

The prohibition of Section 21 is unqualified. It makes no exception for the sponsorship of closed-end investment companies. It is not limited to persons who, in the Board's language, are "primarily or frequently" engaged in the business of issuing, underwriting, or distributing securities at the same time that they are engaged in commercial banking. Bank sponsorship of closed-end funds thus cannot be excused under Section 21 on the ground that such funds "are not primarily or frequently engaged in the issuance, sale and distribu-

tion of securities." Any bank so involved necessarily would be "engaged" to some extent in the critical initial "issuing, underwriting, selling, or distributing" of the fund's securities, in contravention of the mandate of the Section that commercial and investment banking be divorced.

2. *The Background of the Glass-Steagall Legislation Shows That Congress Could Not Have Intended To Exclude Closed-End Investment Companies From the Statutory Prohibitions*

The Board's reading of Glass-Steagall to permit bank sponsorship of closed-end funds ignores specific and voluminous contemporaneous evidence to the contrary. As an historical matter, it was public speculation in closed-end, not open-end, investment companies that was before the Congress at the time of enactment of Glass-Steagall. In 1929, open-end investment companies accounted for only five percent of the total assets of all management investment companies. Not one open-end investment company had been sponsored by a commercial bank or bank affiliate. *See* SEC Report on Investment Trusts and Investment Companies (hereafter "SEC Report") (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 124 (Table 25) (1939). *Every* investment company sponsored by a commercial bank or its securities affiliate, including those whose abuses filled the pages of a contemporaneous SEC study, was of the closed-end variety. *Id.* at 115-24.

Closed-end investment companies were intimately associated with the investment bankers that had sponsored the vast bulk of such funds. *Id.* at 124 (Table 25). As this Court noted in *Camp,* Congress generally intended to divorce commercial banking from the kinds of activities in which investment bankers were engaged.

401 U.S. at 635. On this score alone, there is ample basis to conclude that Congress contemplated that Glass-Steagall would prohibit banks from sponsoring closed-end funds.

There is a certain irony in the Board's suggestion that in prohibiting banks from engaging in securities distributions to any extent—not merely "principally" or even "primarily"—Congress in Section 21 intended to excuse bank involvement in the initial issuance and sale of closed-end fund securities, on the theory that such sales possibly might not be followed by subsequent distributions as in the case of open-end funds. The historical explanation for the different distribution patterns of closed- and open-end funds lay in the different character of their sponsors. Closed-end funds exploited the prestige of their sponsors to achieve rapid distribution through public offerings of securities. Open-end funds relied on the constant selling efforts of their less well-known sponsors over time to achieve distribution. *See* SEC Report, *supra* (Part 3), at 804. Thus,

> "[a]n investment trust or investment company which could obtain the backing of some established institution at once possessed the elements of respectability and experience which the association implied. These connections were of immeasurable value in marketing the shares of investment trusts and investment companies and often the sponsors sought to exploit these affiliations.
>
> "*The reputation which commercial banks,* investment bankers, and brokers *enjoyed* in those years during which the *closed-end* management investment trusts and investment companies received their greatest impetus *was probably utilized and exploited as an aid to distribution as much as*

any other sponsorship." *Id.* at 892 (emphasis supplied).

The contemporaneous materials were replete with accounts of closed-end fund organizers who had sought out association with banking institutions to promote the marketing of the shares of their companies. *E.g., id.* at 892, 907. Based on the prestige of their sponsors, closed-end funds achieved massive public distribution of their securities in the years preceding the enactment of Glass-Steagall, to the point that they far eclipsed open-end funds in importance. As noted above, in 1929 closed-end funds accounted for 95 percent of all the assets of management investment companies in the country. It is far-fetched to suggest that Congress somehow intended to prohibit bank involvement in the trickling securities distribution of open-end funds, while leaving open such involvement in the flash-flood distribution of closed-end funds.

3. *The Functional Similarities of Closed- and Open-End Funds Preclude the Distinction Now Urged by the Board*

Throughout its Brief to this Court, the Board relies upon a single difference between open- and closed-end investment companies—that in the distribution of their shares, open-end companies typically engage in a continuous process of redemption and issue, whereas closed-end companies typically do not continuously issue and sell their own securities. On that basis, the Board urges that the two types of funds may be accorded disparate treatment under the Glass-Steagall Act.

The Board has overstated the difference between open- and closed-end funds, and has failed to show

that the difference is significant in terms of the policies that underlie Glass-Steagall. That is the case even though the Board variously implies that closed-end funds are different *only when* they distribute their shares infrequently (*e.g.*, Pet. Br. 11, 27, 30, 45 n.38) and that they are different because as a *matter of definition* they make such distributions only infrequently (*e.g., id.* at 11, 24-27, 29, 34-35).

First, the ongoing relationship of banks to their sponsored funds does not depend materially on whether the funds are open- or closed-end. In both cases, banks have been intimately involved at the first stages of organization of the funds and during the initial distribution of fund securities. In both cases, the funds' key officers and employees have been officers and employees of the banks. In both cases, the banks have had full sway in the investment operations of the funds, and have assumed other administrative functions and expenses. In both cases, the banks have had a salesman's stake in the performance of the funds, in that their fees typically are defined as a percentage of the funds' net asset values.

Second, closed-end companies may, and do, issue and sell their securities to the public from time to time after the initial distribution of their securities is completed. *See* Appendix A. Under Section 23(b) of the Investment Company Act, 15 U.S.C. § 80a-23(b), a closed-end investment company may sell its stock as long as the price is at the current net asset value of the stock. Moreover, closed-end companies frequently adopt some form of dividend reinvestment plan, whereby the shareholder's periodic dividend is used to pur-

chase additional shares of the fund's stock for the shareholder's account. *See* R. 317.

Third, closed-end funds can, and do, convert into open-end funds. Advance Investors Corporation, one of the closed-end funds sponsored by Citibank, N.A., converted to an open-end fund after commencing existence in the closed-end configuration to take advantage of the Regulation (R. 2915-3102). In allowing banking institutions to sponsor closed-end funds without prohibiting conversion, the Board has created an obvious loophole by which banking institutions may evade the prohibition expressed in *Camp* through the creation of a closed-end fund that can be open-ended at the first convenient opportunity. Also, the Board unnecessarily has placed itself in the position of having to attempt to determine the original intentions of sponsors of closed-end funds when conversions occur. It is not apparent that the Board has rushed to embrace this ongoing policing function in the industry. To the contrary, the Board refused to explore such problems through a public hearing when pressed by the Institute below (R. 172-73) and, so far as we are aware, has undertaken no enforcement action since then.

Fourth, a holding company or its subsidiary is free under the Board's Regulation to sponsor a multiple series of closed-end funds, resulting in the more or less continuous issuance of investment securities to the public. The Board has not explained why such bank sponsorship of a series of closed-end funds should be permitted when the sponsorship of a single open-end fund is not.

Finally, it is true that in the cases of bank-sponsored closed-end funds detailed in the evidence before the

Board, the underwriting and distribution functions formally were placed in the hands of third parties to preserve the appearance of noninvolvement by the banks in those areas. But the banks were involved in all the critical initial contractual arrangements for the launching of the funds. *Camp* proscribes indirect as well as direct engagement of banks in the sale of securities. The grounds for the proscription of indirect involvement are found both in Glass-Steagall Section 16's strict limitations on bank dealings in securities and Section 21's prohibition on a bank's engaging to any extent—not merely "principally" or "primarily"—in the issuance, underwriting, sale, or distribution of securities.

In sum, the language, history, and policies of Glass-Steagall Sections 16 and 21 compel the conclusion that the sponsorship of closed-end investment companies is just as forbidden to banks as is their sponsorship of open-end counterparts. Insofar as the Board's Regulation and Interpretive Ruling purport to authorize such sponsorship, they are unlawful.[5]

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[5] The Board (Pet. Br. 35 n.28) and its supporting *amici* (Am. Br. 21 n.26) suggest that during the course of the administrative proceedings, counsel for the Institute conceded the materiality of the difference between open- and closed-end investment companies. The suggestion is conveyed through the time-honored device of omitting the pertinent aspects of the quotation relied upon. Before the Board, counsel stressed:

> "[T]he Supreme Court pointed out a number of other conflicts which it considered inimical to the best interests of banking that could inhere. An identification of the investment company with the bank, and perhaps a poor performance on the part of the investment company somehow or other operating to lessen public confidence in the bank, that same conflict and that same evil would be present whether the investment company were closed-end or open-end" (R. 195-96).

II. SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT DOES NOT EMPOWER THE BOARD TO AUTHORIZE BANK HOLDING COMPANIES AND THEIR SUBSIDIARIES TO SPONSOR CLOSED-END INVESTMENT COMPANIES

The Board's determination that the sponsorship of closed-end investment companies is "so closely related to banking . . . as to be a proper incident thereto" cannot be sustained. The history of the bank holding company legislation and past rulings of the Board itself, both under Section 4(c)(8) and under other statutory schemes, demonstrate that sponsorship of such investment media for promotion of stock sales to the general public is not a "proper incident" to the banking function and therefore cannot be undertaken by bank holding companies.

A. The Bank Holding Company Act Narrowly Restricts the Nonbanking Activities of Bank Holding Companies to "Proper Incidents" of Banking

1. *The History of the Bank Holding Company Legislation Demonstrates That Congress Intended No Departure from the Pertinent Prohibitions of the Glass-Steagall Act*

The dual objectives of the Bank Holding Company Act of 1956 were to regulate the growth of bank holding companies and to restrict severely the types of activities in which such companies could engage. *See Lewis* v. *BT Investment Managers, Inc.*, 48 U.S.L.W. 4638, 4643 (No. 79-45) (June 9, 1980); S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955); *cf. Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 244 (1978). Said the Senate Committee on Banking and Currency in reporting out the measure:

> "In the opinion of your committee, public welfare requires the enactment of legislation providing

> Federal regulation of the growth of bank holding companies and the type of assets it is appropriate for such companies to control. In general, the philosophy of this bill is that bank holding companies ought to confine their activities to the management and control of banks and that such activities should be conducted in a manner consistent with the public interest. *Your committee believes that bank holding companies ought not to manage or control nonbanking assets having no close relationship to banking.*" S. Rep. No. 1095, 84th Cong., 1st Sess. 1 (1955) (emphasis supplied). *Accord,* H.R. Rep. No. 609, 84th Cong., 1st Sess. 16 (1955).

In their hearings, both houses of Congress had documented abuses that had arisen from the combination of banking and nonbanking enterprises in the same economic unit. *Id.* at 4-5. William McChesney Martin, Jr., Chairman of the Board of Governors, presented his views on the dangers involved generally when bank holding companies enter areas not allowed to banks:

> "[T]here is nothing in existing law which prevents the combination under the same control, through the holding company device, of both banking and nonbanking enterprises. Obviously, this makes it possible for the credit facilities of a controlled bank to be used for the benefit of the nonbanking enterprises controlled by the holding company. Moreover, the ordinary non-banking business requires a managerial attitude and involves business risks of a kind entirely different from those involved in the banking business. Banks operate largely on their depositors' funds. These funds should be used by banks to finance business enterprises within the limitation imposed by the banking laws and should not be used directly or indirectly for the purpose of engaging in other businesses which are not subject to the safeguards imposed by the banking laws." ***Hearings on H.R.***

2674 Before the House Comm. on Banking and Currency, 84th Cong., 1st Sess. 14 (1955).

Thus, Congress determined to subject bank holding companies to the same regulation as the banking institutions that they controlled. Congress recognized that it was just as important for bank holding companies to limit their activities to sound practices as it was for banks to do so. *See* H.R. Rep. No. 609, *supra* at 7, 11.

Section 4(a) of the Bank Holding Company Act, 12 U.S.C. § 1843(a), prohibited bank holding companies owning or controlling two or more banks to acquire or retain interests in any nonbanking enterprises. *See Lewis* v. *BT Investment Managers, Inc.,* 48 U.S.L.W. at 4642. However, Section 4(c)(6) of the Act provided a limited exemption. Under that Section, bank holding companies were permitted to hold

> "shares of any company *all the activities of which are of a financial, fiduciary, or insurance nature and which the Board . . . has determined to be so closely related to the business of banking* or of managing or controlling banks *as to be a proper incident thereto* and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act." 70 Stat. 137 (emphasis supplied).

The court of appeals below carefully reviewed the history of the 1956 legislation. It properly concluded that the Board's authority to act under the exemptive provision of Section 4(c)(6) "was to be a narrow one." 606 F.2d at 1017 (Pet. App. 31a).

In the years following enactment of Section 4(c)(6), the Board's exercise of its powers under the Section was consistent with the understanding reflected in the

court's opinion below. The Board interpreted the language of Section 4(c)(6) to require a "direct and significant connection" between the proposed activities of the company to be acquired by the bank holding company and the business of banking as conducted by the particular bank holding company or bank subsidiary involved. *See Hearings on H.R. 6778 Before the House Comm. on Banking and Currency,* 91st Cong., 1st Sess., Part 1, at 199 (1969) (statement of Chairman Martin); *cf. Application of TransAmerica Corp.,* 43 Fed. Res. Bull. 1014 (1957).

Significantly, there is no indication that the banking industry ever regarded the 1956 legislation as having removed the prohibitions against entry into securities marketing originally stated in the Glass-Steagall Act. That understanding also is reflected in the subsequent legislative recognition that the 1956 Act was intended to apply "the general purposes of the Glass-Steagall Act of 1933—to prevent unduly extensive connections between banking and other businesses." S. Rep. No. 1179, 89th Cong., 2d Sess. 2 (1966).

In 1966, Congress amended the Bank Holding Company Act, without effecting any pertinent change in the law. Section 4(c)(6) was renumbered Section 4(c)(8), without substantive change. 80 Stat. 239. Other changes, also of a technical nature, related to the provisions of Glass-Steagall concerning bank affiliates and holding companies. These changes will be considered in Part III of this Brief.

In 1970, Congress again amended the Bank Holding Company Act. The court of appeals below, which comprehensively reviewed the 1970 amendments, correctly identified their main objective as the extension of the

requirements and prohibitions of the 1956 Act to one-bank holding companies. 606 F.2d at 1018 (Pet. App. 32a-33a). Prior to 1956, such holding companies had formed a relatively insignificant part of the American banking industry, being limited primarily to companies controlling small banks. However, following the adoption of the Bank Holding Company Act, the number of one-bank holding companies increased dramatically, reaching a peak in the late 1960s.[6] Equally important, the device became popular with the nation's largest banks as a means of engaging in nonbanking enterprises free from federal regulatory control. *See Staff of House Comm. on Banking and Currency,* 91st Cong., 1st Sess., *The Growth of Unregistered Bank Holding Companies—Problems and Prospects* 6-7 (Comm. Print 1969); 115 Cong. Rec. 32898-900 (1969) (remarks of Representatives Widnall and Del Clauson); *Board of Governors* v. *First Lincolnwood Corp., supra,* at 247. As J. L. Robertson, Vice Chairman of the Board of Governors, told the House Committee on Banking and Currency:

> "when Congress has clearly limited the powers of banks, they should not be permitted to circumvent such limitations either through subsidiary corporations or through affiliation in a holding company system. If the limitation is to be removed or modified, it should be by congressional action. Before Congress does act to alter a limitation, it should decide whether the proposed activity is appropriate for banks to engage in directly. If so, the law should be changed in order that they may do so

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[6] For a discussion of the increased use of the one-bank holding company device, *see American Banker,* Feb. 5, 1969, at 16, col. 1; Shapiro, *The One-Bank Holding Company Movement: An Overview,* Banking L. J. 291 (1969).

> themselves, as well as through a subsidiary or through an affiliate in a holding company." Hearings on H.R. 6778, *supra* at 207 (1969).

As part of the 1970 amendments, Congress revised Section 4(c)(8) to exempt from the prohibition against nonbanking activities the holding company's possession of

> "shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be *so closely related to banking or managing or controlling banks as to be a proper incident thereto.*" 84 Stat. 1765 (emphasis supplied).[7]

The Section, as revised, retained the central formulation of the provision as originally enacted—that the exempted activity be "so closely related to banking . . . as to be a proper incident thereto . . . ." However, the proposed revision went through numerous stages before its reversion to the original language. Before the Congress, the Board had favored legislation that would have substituted the phrase "functionally related" for the "closely related" language of Section 4(c)(8), but that explicitly would have barred bank holding company sponsorship of investment companies in language essentially identical to Glass-Steagall Sec-

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[7] The replacement of the phrase "business of banking" with the word "banking" was intended to permit the Board to authorize activity closely related and properly incident to banking generally, rather than to the particular bank whose holding company happened to invoke the statute. 606 F.2d at 1020 (Pet. App. 38a); *cf.* Pet. Br. 47 n.42. The court below correctly described this change as expanding the geographic markets, but not the lines of commerce, of services deemed to meet the statutory criteria. 606 F.2d at 1020 (Pet. App. 38a). Similarly, the deletion of the phrase "of a financial, fiduciary or insurance nature" was intended to eliminate a redundancy (*see* Pet. Br. 48 n.42).

tion 20. *Hearings on H.R. 6778 Before the House Comm. on Banking and Currency,* 91st Cong., 1st Sess., Parts 1 & 2, at 90, 175, 418, 549 (1969); *Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Comm. on Banking and Currency,* 91st Cong., 2d Sess., Part 1, 18 (1970). In appearing before the Senate Committee, the Administration spokesman made clear that the government welcomed an explicit exclusion of bank holding companies from the "securities business," which exclusion he described as "traditional for years . . . ." *Id.*

In their reported bills, both the Senate and House committees included the "functionally related" language, although their reasons for the change differed, the Senate apparently intending to give the Board greater flexibility. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970). The House Committee adopted the "functionally related" language but would have prohibited holding company acquisition or retention of shares of any company "[e]ngaging in the underwriting, public sale, or distribution of mutual funds." H.R. Rep. No. 91-387, 91st Cong., 1st Sess. 9 (1969). That provision was not strong enough for the full House, which amended it on the floor to cover

> "[e]ngaging in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds or other similar securities, or of interests in any such securities, *whether or not any such interests are redeemable* and whether or not the securities to which any such interests relate are in a fund or account or are subject to discretionary sale or purchase . . . ." 115 Cong. Rec. 33133, 33139 (1969) (emphasis supplied).

The underscored language, which could be seen as a response to the newly emerging "functionally related" test, plainly would have subjected closed- as well as open-end funds to the general prohibition of Section 4(a).

The final language of Section 4(c)(8) was determined in conference. The result was the deletion of the specific prohibition against securities activities contained in the House version, but a return to the "closely related . . . proper incident" language of the 1956 Act.

Significantly, a colloquy on the Senate floor upon the adoption of the Conference Committee Report confirms the congressional understanding that the amended Section 4(c)(8) would not affect the Glass-Steagall proscriptions:

> "MR. WILLIAMS of New Jersey. I have one question I should like to ask the chairman of the committee.
>
> "Both the Senate and House bills contained, in Section 4(c)(8), substantially similar language reiterating the existing law embodied in the Glass-Steagall Act which provides, essentially, for separation of commercial banking and the securities business. This language does not appear in the bill agreed to by the conferees. *I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.*
>
> "MR. SPARKMAN. *The answer to the Senator's question is that there clearly was not. As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business.* There are some specific exceptions, of

course, but I can assure you that we did not mean to enlarge or contract them here. We regarded that general prohibition as being so clearly applicable to the subjects of this bill as to make a restatement of it unnecessary. The provision to which you referred is already complicated enough. In short, *we did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act. If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation.* I hope there is no longer any misconception on that point.

"MR. WILLIAMS of New Jersey. It is reassuring, indeed, to know that the Glass-Steagall Act has not been disturbed in any way and that there is no intention at all here to do so." 116 Cong. Rec. 42430 (1970) (emphasis supplied).

In sum, the Bank Holding Company Act of 1956 and its 1966 and 1970 amendments left intact the pertinent prohibitions of Glass-Steagall. The Glass-Steagall policy of divorcing commercial banks from the issuance and marketing of securities was reaffirmed.

2. *The Board Cannot Show That Activity Affirmatively Prohibited to Banks Under Glass-Steagall Sections 16 and 21 Nonetheless Is a "Proper Incident" of Banking Under Section 4(c)(8)*

Before this Court, the Board intimates that under Section 4(c)(8), as amended in 1970, it somehow acquired a broad administrative discretion to authorize a wide range of activities that the Board believes meet the "closely related" standard (*e.g.*, Pet. Br. 47). The Board's argument overlooks that under Section 4(c)(8), even following the 1970 amendment, the statutory test is not simply one of "relatedness." Rather, the

question posed by the statute in each case is whether the proposed activity is "*so* closely related to banking . . . as to be a *proper* incident thereto" (emphasis supplied).

Both the language of the statute and the history of the 1970 amendments demonstrate that two distinct standards—a "close relation" and a "proper incident" —must be met. H.R. Rep. No. 91-1747, 91st Cong., 2d Sess. 21-22 (1970). *Accord, NCNB Corp.* v. *Board of Governors,* 599 F.2d 609, 610-11 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors,* 568 F.2d 549, 551-52 (7th Cir. 1978); *National Courier Association* v. *Board of Governors,* 516 F.2d 1229, 1232 n.2 (D.C. Cir. 1975); *Independent Bankers Association of Georgia* v. *Board of Governors,* 516 F.2d 1206, 1215 (D.C. Cir. 1975); *BankAmerica Corp.* v. *Board of Governors,* 491 F.2d 985, 988 (9th Cir. 1974). The Board itself has acknowledged that a two-part test is involved. *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors, supra,* 568 F.2d at 551-52.

The legality of the proposed activity necessarily is considered a part of the "proper incident" test under Section 4(c)(8), for statutes proscribing a given activity reflect public policy as determined by the legislature. *See, e.g., Alabama Association of Insurance Agents* v. *Board of Governors,* 533 F.2d 224, 252-53 (5th Cir. 1976), *vacated in part,* 558 F.2d 729 (1977), *cert. denied,* 435 U.S. 904 (1978); *Independent Bankers Association of Georgia, supra,* 516 F.2d at 1222-24. The Board has recognized the impropriety of permitting bank holding companies to engage in activities that are forbidden by law to banks. *Montana Shares, Inc.,* 47 Fed. Res. Bull. 767, 772 (1961).

As we have demonstrated above in Part I of this Brief, the Glass-Steagall Act prohibits banks from

sponsoring investment companies, whether open- or closed-end. This is not simply a situation in which the activity happens to be *ultra vires* the banks' statutory authority. As a matter of positive law, Glass-Steagall affirmatively prohibits such activity on the part of banks. It follows that the Board cannot find such activity to be "a proper incident" of banking under Section 4(c)(8) for bank holding companes. Were it otherwise, a bank such as Citibank, which failed in *Camp* in its effort to sponsor its own securities investment vehicle, could accomplish the forbidden result by creating a parent one-bank holding company and causing that parent to sponsor a closed-end fund.

The Board contends that its interpretation of Section 4(c)(8) somehow draws support from the immediately preceding Section 4(c)(7), 12 U.S.C. § 1843 (c)(7). *See* Pet. Br. 42-43. Again, the Board errs. Section 4(c)(7) originated in 1956 as Section 4(c)(5). That section exempted from the investment requirements of the Act

> "the *ownership* by a bank holding company of shares, securities, or obligations of an investment company which is not a bank holding company and which is not engaged in any business other than investing in securities, which securities do not include more than 5 percentum of the outstanding voting securities of any company and do not include any single asset having a value greater than 5 percentum of the value of the total assets of the bank holding company." 70 Stat. 136 (emphasis supplied).

The legislative history of this Section makes clear that the provision was drafted to allow a specific bank holding company in Kentucky to retain its pre-existing ownership of its interest in a subsidiary investment

company. 102 Cong. Rec. 6128 *et seq.* (1956). A similar provision had appeared in some of the bills introduced in Congress prior to 1956, but it was not in the Senate bill that was reported out of committee. *Id.* The provision was added on the Senate floor. There was general recognition that in its absence, the Kentucky bank holding company in question would be unable to retain its investment in the investment company securities. *Id.*

As written, Section 4(c)(7) permits bank holding companies to make the same investments indirectly, through the means of an investment company, that they could make directly under Section 4(c)(6), which authorizes a bank holding company to retain or acquire "shares of any company which do not include more than 5 per centum of the outstanding voting shares of such company." 12 U.S.C. § 1843(c)(6). If anything, Section 4(c)(7) reflects a congressional determination that bank holding company involvement with investment companies shall be limited to "ownership" of such companies' stock, under narrowly defined circumstances. Mere ownership of investment company stock is a far cry from sponsorship of a closed-end investment company the shares of which are issued, offered, sold, and distributed to the public. Surely, Congress in legislating the tightly circumscribed provision for continued stock *ownership* in Section 4(c)(7), did not simultaneously intend to leave open the possibility of wholesale investment company *sponsorship* in the immediately following Section 4(c)(8).

B. Regulatory Rulings of the Board Confirm That Bank Holding Company Sponsorship of Investment Companies Cannot Be Deemed a "Proper Incident" of Banking

In a final effort to sustain its Regulation and Interpretive Ruling, the Board urges (Pet. Br. 53-59) that

the sponsorship of closed-end investment companies is an activity "closely related" to the traditional fiduciary functions of commercial bank trust departments, and therefore may appropriately be exempted under Section 4(c)(8).

The Board's litigating position is at variance with its settled regulatory practice. The Board previously has not considered that the creation and sale of investment media to the public are an appropriate fiduciary function. To the contrary, throughout the period of its supervision of the trust powers of national banks from 1913 until 1962, the Board consistently warned against abuse of the authority to employ common trust funds, and strictly limited such funds to trusts created for "bona fide" or "strictly fiduciary purposes." 24 Fed. Res. Bull. 4-5, 10 (1938). The Board held that it was "improper" for a bank to use "the common trust fund as a medium attracting individuals primarily seeking investment management of their funds." 42 Fed. Res. Bull. 228 (1956); *see also* 41 Fed. Res. Bull. 142 (1955); 92 *Trusts and Estates* 319-20 (1953). In ruling that "a Common Trust Fund should be used merely to aid in the administration of trusts by a trust institution through the commingled investment of funds of various trusts," the Board said:

> "While the operation of a Common Trust Fund might thus enable a trust institution to accept small trusts which it otherwise would be unwilling to handle, it was contemplated that trust guise or form should not be used to enable a trust institution to operate a Common Trust Fund as an investment trust attracting money seeking investment alone *and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments.*" 26 Fed. Res. Bull. 393 (1940) (emphasis supplied).

As late as 1960, the Board proposed an amendment to its Regulation in order to ensure a "bona fide fiduciary purpose" in the use of common trust funds. 25 Fed. Reg. 12479 (1960). The Regulation would have excluded *inter vivos* trusts entirely from participation in common trust funds. *Id.* The proposal lapsed when the Board's supervisory authority with respect to national banks was transferred in 1962 to the Comptroller of the Currency.

Interestingly, the American Bankers Association, which appears here as *amicus* in support of the Board, has warned that a bank may not

> "operate a common trust fund so as to compete with savings departments or investment trusts, merely to swell the volume of its trust assets through the attraction of money seeking investment alone." Trust Division, American Bankers Association, *Common Trust Funds* 16 (2d ed. 1948); *see also id.* at 17, 22-23.

In sum, because the sale of investment media to the public never has been regarded as a proper activity of banks, the Board's Regulation cannot satisfy the statutory test that the activity approved be "so closely related to banking . . . as to be a proper incident thereto" under Section 4(c)(8).

III. THE REGULATION AND INTERPRETIVE RULING ARE INVALID AS APPLIED TO BANK HOLDNG COMPANIES

In issuing its Regulation and Interpretive Ruling, the Board acknowledged that the Glass-Steagall Act's prohibitions apply to bank holding companies as well as to banks. Indeed, while attempting to carve out an exemption for *closed*-end investment companies from

the strictures of the Act, the Board expressly determined that the sponsorship, organization, or control of an open-end investment company is forbidden to bank holding companies under Glass-Steagall. 12 C.F.R. § 225.125(f) (Pet. App. 85a).

Even though the Board's recognition of the Glass-Steagall limitations plainly derived from this Court's *Camp* decision, which rested upon Sections 16 and 21, the Board now seeks to put those Sections to one side, on the theory that they apply only to banks (Pet. Br. 23 n.15). Instead, the Board now contends that the only extant provision of Glass-Steagall that deals with the sponsorship of a closed-end investment company by a bank holding company or its nonbank subsidiary is Section 20 (*id.* at 23), a provision not even at issue in *Camp*.

As we shall demonstrate in this section of the Brief, the Board's argument is unpersuasive. It ignores the plain language of the Act, Congress' concern with the relationship between commercial bank affiliates and investment companies, and this Court's teachings in *Camp*.

A. Bank Holding Company Sponsorship of Investment Companies Violates the Glass-Steagall Act

The Glass-Steagall Act set out to divorce commercial banking from the issuance and marketing of securities to the maximum extent that Congress believed was constitutionally permissible. The background of the Glass-Steagall legislation

> "conclusively demonstrates that it was the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwrit-

> ing and dealing in securities." *Baker, Watts & Co.* v. *Saxon,* 261 F. Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Auth'y* v. *Baker, Watts & Co.,* 392 F.2d 497 (D.C. Cir. 1968).

That divorce involved not only banks but their affiliates —bank subsidiaries, "sibling" corporations under common control with banks and corporate parents or holding company affiliates—all of which Senator Glass, sponsor of the legislation, referred to as "this Frankenstein in banking . . . ." 75 Cong. Rec. 9984 (May 11, 1932).

Under Glass-Steagall Section 16, national banks and state member banks were strictly limited in their purchases and sales of securities to acting for their customers' accounts and at their customers' orders. Under Section 20, national and state member banks were barred from affiliation with corporations engaged in the business of securities flotation and distribution. Under Sections 5(c), Seventh and 19, holding company affiliates of member banks were subjected to similar restraints by recourse to a requirement that they obtain a permit from the Board before voting the shares of the banks under their control. Under Section 21, all entities engaged in any respect in the commercial banking function, whether or not national banking associations, state member banks in the Federal Reserve System, or others, were banned from the securities marketing business. Finally, under Section 32, even if no formal corporate affiliation existed, personal interlocks between the securities marketing business and the commercial banking business were forbidden to a substantial degree.

There can be no doubt that Congress, in enacting Glass-Steagall, believed it had undertaken every pos-

sible remedial step within its constitutional power, as then understood, to divorce the banking industry from the issuance and marketing of securities to the general public.

As early as 1911, in a formal opinion to the Attorney General, the Solicitor General opined on the legality of a national bank's establishment of an "investment company," the shares of which were made available ratably to the shareholders of the bank, were tied to the bank's own securities, and further were pledged in trust to the operating trustees of the investment company. The Solicitor General condemned the arrangement as a violation of the national banking laws, which, he said, required that "the bank shall be conducted as a bank pure and simple *and not as a promoting agency of speculative investment companies.*" 75 Cong. Rec. 9899-9904 (1932) (emphasis supplied). Senator Glass made much of this opinion in his speech introducing the Glass legislation on the Senate floor, and references to the opinion figured prominently in the debates thereafter. *See, e.g.,* 75 Cong. Rec. 9887-89, 9898-904, 9909, 9911, 9975, 10069-70 (1932); 76 *id.* 1940, 1994 (1933); 77 *id.* 3725-26 (1933).

In 1920, the Comptroller of the Currency expressed concern about the proliferation of "securities companies" as affiliates of national banks:

> "*'Securities Companies' as Adjuncts to National Banks Often a Menace*
>
> "Some 'securities companies' operating in close connection with, and often officered by, the same men who manage the national banks with which they are allied, have become instruments of speculation and headquarters for promotions of all kinds of financial schemes. Many of the flotations promoted by the 'securities corporations' which

are operated as adjuncts to national banks have proven disastrous to their subscribers, and have in some instances reflected seriously not only upon the credit and the standing of the 'securities companies' by which they are sponsored, but also in some cases have damaged the credit and reputation of national banks with which the 'securities companies' are allied.

"It has been established clearly by decisions of the United States Supreme Court that a national bank can not, except as authorized by the Federal reserve act, hold the stock of other national banks or the stock of other corporations; *but these adjunct or auxiliary companies whose stockholders are identical with the stockholders of the national banks with which they are connected by various ties and devices frequently deal actively in stocks,* and they also sometimes acquire the ownership or control of other banks, National and State, through their stock purchases.

"In times of rising prices and active speculation some of these auxiliary corporations have made large profits through their ventures and syndicate operations, but their losses in other periods have been heavy, and they have become an element of increasing peril to the banks with which they are associated. *The business of legitimate banking is entirely separate and distinct from the kind of business conducted by many of the 'securities corporations,'* and it would be difficult, if not impossible, for the same set of officers to conduct safely, soundly, and successfully the conservative business of the national bank and at the same time direct and manage the speculative ventures and promotions of the ancillary institutions. These varying institutions demand a different kind of ability and experience on the part of those who manage them, and the two types of busi-

> ness when combined with one management are likely to be operated to the advantage of neither.
>
> * * *
>
> "*These ancillary companies are being used with increasing frequency for promotion of speculation and for dealing in bonds and stocks,* often those of new and unseasoned issues, and which are attended with improper hazard risk, *and as a means of enabling banks to do, indirectly through their instrumentality, things which they can neither safely nor lawfully do directly.*" 1920 Comptroller's Report, vol. 1, at 55-56.

This material too was brought before the Senate during its deliberations of the Glass bill. *See Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 71st Cong., 3d Sess., Appendix (Part VII), at 1067-68 (1931).

By March 1933, when President Roosevelt assumed office, the banking industry was in crisis. Thousands of banks, including many of the largest banks in the nation, had failed. *See* 75 Cong. Rec. 9892 (1932) (remarks of Sen. Glass). Depositors by the millions were confronted with the certain or likely loss of all or a substantial portion of their bank deposits. One of President Roosevelt's first actions was to declare an unprecedented "bank holiday." Presidential Proclamation No. 2038 (March 6, 1933); Presidential Proclamation No. 2039 (March 9, 1933); 1 A. Schlesinger, Jr., *The Age of Roosevelt* 474-81 (1957); 2 id. 4-8 (1959); and *see* authorities collected in Pet. Br. 32 n.25.

The Glass-Steagall legislation was adopted as the Banking Act of 1933 on June 16, 1933. It was one of the major pieces of reform legislation that moved to enactment through the Congress as part of the First

Hundred Days of the Roosevelt Administration. 2 A. Schlesinger, Jr., *supra* at 20-21. Whether viewed individually or in the aggregate, three statutory provisions of Glass-Steagall—Section 19, supplemented by Section 5(c), Seventh; Section 20; and Section 21—reflect a congressional determination to remove both banks *and* their affiliates from the type of involvement with investment companies that, in the view of Congress, had contributed to the debacle of the early 1930s.

1. *Sections 19 and 20 Removed Bank Affiliates and Holding Companies from the Business of Issuing and Marketing Securities*

Section 20 of Glass-Steagall was targeted at subsidiary and sibling corporations of national banking associations. This provision barred any member bank (whether a national banking association or a state member bank) from involvement with a subsidiary corporation or one under common control with the bank that in turn was involved in issuing and marketing securities. Specifically, Section 20 provided:

> "After one year from the date of the enactment of this Act, *no member bank shall be affiliated in any manner described in section 2 (b) hereof with any* corporation, association, business trust, or other similar *organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail* or through syndicate participation of stocks, bonds, debentures, notes, or other securities." 48 Stat. 188 (emphasis supplied).

The effect of the reference in Section 20 to the affiliations described in Section 2(b) was to confine the operation of Section 20 to affiliations between member banks on the one hand and their subsidiary and sibling

corporations on the other.[8] As Senator Walcott, one of the spokesmen for the legislation on the Senate floor, put it:

> "[W]hen we use the term 'affiliate' in this sense and in connection with this bill, we mean that divorced subsidiary of a bank, whether State or National makes no difference, whose business it is to underwrite, *purchase, and/or sell* various securities as they come along in the market from day to day and week to week." 75 Cong. Rec. 9905 (1932) (emphasis supplied).

The reason for Congress' enactment of Section 20 is clear. One of the primary abuses that motivated Congress to pass the Act was the widespread practice among commercial banks of engaging in the issuing and marketing of securities indirectly, through securi-

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[8] Section 2(b) of the Act adopted a definition of "affiliates" that reached both subsidiaries of banks and their sibling corporation, including

> "any corporation, business trust, association, or other similar organization—
>
> "(1) Of which a member bank, directly or indirectly, owns or controls either a majority of the voting shares or more than 50 per centum of the number of shares voted for the election of its directors, trustees, or other persons exercising similar functions at the preceding election, or controls in any manner the election of a majority of its directors, trustees, or other persons exercising similar functions; or
>
> "(2) Of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank who own or control either a majority of the shares of such bank or more than 50 per centum of the number of shares voted for the election of directors of such bank at the preceding election, or by trustees for the benefit of the shareholders of any such bank; or
>
> "(3) Of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank." 48 Stat. 162-63.

ties or investment affiliates. The Senate Report accompanying the legislation said:

> "There seems to be no doubt anywhere that a large factor in the overdevelopment of security loans, and in the dangerous use of the resources of bank depositors for the purpose of making speculative profits and incurring the danger of hazardous losses, has been furnished by perversions of the national banking and State banking laws, and that, as a result, machinery has been created which tends toward danger in several directions.
>
> "*The greatest of such dangers is seen in the growth of 'bank affiliates' which devote themselves in many cases to perilous underwriting operations,* stock speculation, and maintaining a market for the banks' own stock often largely with the resources of the parent bank. This situation was never contemplated by the National Banking Act, and it would, therefore, appear that the affiliate system calls for the establishment of some legislative provisions designed to deal with the situation." S. Rep. No. 77, 73d Cong., 1st Sess. at 9-10 (emphasis supplied).

To like effect, the Senate Committee on Banking and Currency, writing of the activities of commercial banks during the period prior to 1933, noted:

> "Commercial banks not only played a vital part in securities transactions by the extension of credit to carry on these activities, but *directly engaged, in circumvention of the law, through the medium of their investment affiliates, in securities and other transactions prohibited to commercial banks.* This participation of commercial banks in the investment-banking field ultimately resulted in such gross abuses and malpractices, and occasioned such

losses to the banking institutions and the investing public, that the banking act of 1933 was passed divorcing commercial banking from investment-banking institutions." S. Rep. No. 1455, 73d Cong., 2d Sess. 156 (1934) (emphasis supplied).

Section 19 of Glass-Steagall controlled holding company affiliates. It imposed sweeping and stringent conditions upon such affiliates' exercise of the right to vote their stockholdings in the national banking associations. 48 Stat. 186. In a complementary provision, Section 5(c), Seventh imposed parallel conditions upon holding companies affiliated with state member banks. 48 Stat. 166. Holding company affiliates were defined in Section 2(c) of the Act to include any organization "[w]hich owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of any one bank at the preceding election, or controls in any manner the election of a majority of the directors of any one bank." 48 Stat. 163.

Section 19 was repealed in 1966, but that repeal was a technical revision only, without impact on the substantive law. As the Board correctly concedes (Pet. Br. 4 n.5, 17, 43, 47-50 & n.43, 52, 53), neither the Bank Holding Company Act of 1956 nor the amendments to that statute adopted in 1966 and 1970 cut back on the prohibitions contained in Glass-Steagall. *Accord, Board of Governors* v. *First Lincolnwood Corp.,* 329 U.S. at 246-47; S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). Thus, Section 19 properly may be considered at this point of the analysis.

In the provision directly pertinent here, Section 19, Fifth required a bank holding company applying for

permission to vote the shares of a subsidiary member bank to agree to remove itself from involvement in the operation of "securities companies" within five years of the filing of the application. In pertinent part, the paragraph provided:

> "Every such holding company affiliate shall, in its application for such voting permit, (1) show that it *does not own, control, or have any interest in, and is not participating in the management or direction of, any* corporation, business trust, association, or other similar *organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution,* at wholesale or retail or through syndicate participation, *of stocks, bonds,* debentures, notes, *or other securities of any sort* (hereinafter referred to as 'securities company'); (2) agree that during the period that the permit remains in force it will not acquire any ownership, control, or interest in any such securities company or participate in the management or direction thereof; [and] (3) agree that if, at the time of filing the application for such permit, it owns, controls, or has an interest in, or is participating in the management or direction of, any such securities company, it will, within five years after the filing of such application divest itself of its ownership, control, and interest in such securities company and will cease participating in the management or direction thereof, and will not thereafter, during the period that the permit remains in force, acquire any further ownership, control, or interest in any such securities company or participate in the management or direction thereof . . . ." 48 Stat. 188 (amending R.S. § 5144(e)) (emphasis supplied).

It is apparent that the underscored portion of the paragraph essentially parallels the provision in Section 20, set forth above, that barred member bank

affiliations with securities-company subsidiary or sibling corporations.

In explaining its recourse to the permit procedure in Section 19, the Senate Report accompanying the legislation noted the evil presented by the phenomenon of "group banking" but explained the difficulties, believed to be of a constitutional nature, in dealing with the parent entities directly as in the case of member banks:

> "Closely allied in many points of similarity with the affiliate system is the plan of group banking in operation in some parts of the United States, working, in a few cases, on a large scale. In this system a holding company is organized under State law and proceeds to buy a majority of the stock of a series of banks, operating them thereafter through the holding company. In this way in some districts such holding companies control the reserve bank of the district through ownership of enough banks to carry an election. The difference between this plan and the affiliate system itself is that in the one banks are owned by a State-organized holding company, while in the other State-organized companies (affiliates) are owned by a national bank's stockholders, or in some cases directly by trust companies, under some form of law which amounts to ownership by the parent bank itself. *The evils of indirect control are similar in the two cases, and they may lead to similar abuses, as is seen when it is noted that holding companies also usually control companies organized for security financing.* However, such companies have in some parts of the United States become well rooted, and the difficulty of eliminating or abolishing them in any effective way is similar to the difficulty of eliminating or abolishing the affiliates of city banks. It is, therefore, thought best to attempt the control

and oversight of these companies on the following terms:

"(1) *Since the companies are State corporations, Congress has no control over them, except that which may be voluntarily granted.* However, since the staple of their ownership or holdings is the stock of National and State member banks, *it would seem that Congress may control the conditions under which such stocks may be owned and particularly voted.*

"(2) The affiliates of this type (holding companies) are prohibited from voting the stocks of national banks unless they are willing to undertake to accept examination by the Federal Reserve Board, *divest themselves of ownership of stock and bond financing concerns,* and comply with regulations designed to insure their ownership of sufficient free assets to make sure that they can satisfy the double liability of their shareholders in case any of the banks owned by such a company should go into the hands of receivers or be closed." S. Rep. No. 77, *supra,* at 10-11 (emphasis supplied).

There can be no doubt that Sections 19 and 20 together were intended to put bank affiliates—whether holding companies, subsidiaries, or siblings—out of the business of issuing and marketing securities. *See* 75 Cong. Rec. 9887, 9889 (remarks of Sen. Glass) (1932); 77 *id.* 3725, 3726 (same) (1933); 77 *id.* 3835 (remarks of Rep. Steagall) (1933). As the court below summarized the situation, Section 19's treatment of holding company affiliates "did not stem from any congressional perception that the securities activities of bank holding companies or their non-bank affiliates were any less insidious than those of banks themselves. . . . [I]t is clear that the hazards . . . of affiliation be-

tween banks and securities firms were present in the case of holding company affiliates also. . . . The different treatment for holding company affiliates stemmed solely from a congressional concern that, under the commerce clause as then restrictively interpreted, Congress did not have power to force a state-chartered bank holding company to divest itself of a state-chartered securities affiliate." 606 F.2d at 1015-16 (footnotes omitted) (Pet. App. 26a-28a); *see* especially *id.* at 1015-16 n.28 (Pet. App. 26a-27a).

In 1966, as noted above, Congress repealed Section 19. At the same time, it amended the definition of "affiliate" in Glass-Steagall Section 2(b) so as to combine it with the definition in Section 2(c) of "holding company affiliate," which was repealed. 80 Stat. 242. One effect of the amendment to Section 2(b) was to apply Glass-Steagall Section 20, the scope of which turned on the definition of "affiliate" in Section 2(b), to affiliations between member banks and their holding companies, as well as between member banks and their subsidiary and sibling corporations. Thus, Glass-Steagall's broad objective of regulating bank holding companies in Section 19 effectively was preserved in Section 20. *See* S. Rep. No. 1095, 84th Cong., 1st Sess. 12 (1955).

The scheme of bank holding company regulation as originally framed in Glass-Steagall Sections 2(b) and 19 renders irrelevant the contention, now advanced by the Board and its supporting *amici,* that it is the investment company, rather than the bank holding company itself, that technically is engaged in the "issue . . . public sale, [and] distribution" of securities (Pet. Br. 29; Am. Br. 17-21). Even as amended, Glass-Steagall still reaches sibling cor-

porations through Section 2(b) as amended and Section 20. On this basis, the Board properly concedes that a closed-end investment company managed by a bank holding company is a bank "affiliate" within the meaning of Glass-Steagall (Pet. Br. 11, 24 n.16). It hardly would accord with economic reality to deny that the sponsoring entity—the bank holding company—is itself fully involved in the "issue, . . . public sale, [and] distribution" of the securities of its investment company affiliate.

Rather, the Board seeks to avoid Section 20 (with its embodiment of holding company regulation from the old Section 19) on the ground that closed-end funds somehow are not "principally" engaged in the issuance of securities. This is the case, says the Board, because such funds "do not continuously issue and sell their own securities" (Pet. Br. 26). But as we have shown in Part I of this Brief, the Board's analysis fails to take into account that Glass-Steagall nowhere provides for such a distinction, and that its authors never contemplated the notion that the Act would reach only investment trusts of the open-end variety.

There is not one word in the Glass-Steagall legislative history that would support the Board's position that bank affiliate sponsorship of *open*-end investment companies was to be prohibited by Sections 19 and 20, while such sponsorship of *closed*-end companies was not. Certainly, the Board points to no such history. Instead, the Board invokes *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947). There this Court construed the language of Glass-Steagall Section 32, which prohibits interlocking managements between national or state member banks on the one hand and, on the other, firms "engaged primarily in the business of purchas-

ing, selling, or negotiating securities . . . ." The Court noted approvingly the conclusion of the court below that Glass-Steagall had abolished as part of the bank affiliate system all underwriter affiliates that were either under the control of a member bank or were under common control with such a bank. 329 U.S. at 448. The Court further agreed with the Board that Glass-Steagall Section 32 should not be limited to circumstances in which the investment houses in question derived 51 percent or more of their income from the underwriting business. Rather, the Court held that Section 32 should be understood to refer to "essential" or "fundamental" business activities. The Court in *Agnew* was not called upon to consider whether the sponsorship of closed-end investment companies amounted to an activity prohibited by other provisions of Glass-Steagall, nor did the Court express an opinion on that question.

The Board (Pet. Br. 22-23) makes much of the discussion in *Agnew* of the varying degrees of involvement in the securities business with which Congress was concerned in Glass-Steagall—"those 'engaged' in underwriting, those 'primarily engaged' in underwriting, those 'engaged principally' in underwriting." 329 U.S. at 448. That passage is of no help to the Board here. Even on the assumption that Section 21 (to be discussed immediately below) contains a stricter prohibition than Section 20, barring any organization from both issuing securities and receiving deposits, so that the magnitude of the securities activities of the banking institutions within its reach is irrelevant, the prohibition found in Section 20, although less sweeping, still applies fully here. A closed-end investment company is not engaged in many different busi-

nesses. Its *raison d'etre* is to sell participations as an investment vehicle to the public. Such an entity necessarily is "principally engaged" in the issuance of securities.

It merits emphasis that the Board concedes that a bank holding company is prohibited by Section 20 from sponsoring an *open*-end investment company because an open-end investment company is "principally engaged" in the issuance of securities. The discussion of the functional similarities between closed- and open-end funds in Section I of this Brief demonstrates that the distinction drawn by the Board cannot be sustained. *See* pp. 29-32 *supra.* In addition, the initial sponsorship and distribution to the public of interests in the closed-end fund are all that is necessary to constitute a violation of Section 20. It is irrelevant that after such sponsorship and distribution have taken place, the closed-end fund may or may not issue securities thereafter. The "principal engagement" takes place at the time of the initial offering, when the distribution of the securities is the *only* activity of the entity.

2. *Section 21 Reinforced the Separation of Commercial Banking from Securities Issuing and Marketing*

Section 21 of Glass-Steagall, discussed in Part I of this Brief, provided a sweeping, all-inclusive ban on the admixture of the business of issuing and marketing securities and the business of banking. This Section imposed a death sentence, subject to a one-year grace period, upon *any* entity's engagement in commercial banking, when at the same time that entity was involved in the business of issuing and marketing securities. The provision was subject to enforcement by re-

course to criminal penalties prescribed in Section 21(b).

The prohibition contained in Section 21 was stated in the broadest possible terms. Unlike other Sections in Glass-Steagall, there was no qualification in Section 21 based upon the status of the regulated entities as federal or state, or member or nonmember banks.

The reach of Section 21 was confirmed by a technical amendment enacted in 1935. That amendment added the following proviso immediately after the original language:

> "*Provided,* That the provisions of this paragraph shall not prohibit *national banks or State banks or trust companies (whether or not members of the Federal Reserve System) or other financial institutions or private bankers* from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 5136 of the Revised Statutes, as amended [by Glass-Steagall Section 16]." 49 Stat. 707 (emphasis supplied).

Thus, at the same time that it excepted from coverage the narrow range of securities activities permitted to national banks under Glass-Steagall Section 16, the 1935 proviso established that the prohibition of Section 21 extended to "national banks or State banks or trust companies (whether or not members of the Federal Reserve System) [and] other financial institutions or private bankers."

The Board now maintains that Section 21 somehow is inapplicable to bank holding companies (Pet. Br. 20). That is a reversal of the Board's view, implicitly embodied in its Interpretive Ruling, that this Court's decision in *Camp* (and therefore presumably Section

21) barred authorization to bank holding companies to sponsor open-end funds.

The limitation of Section 21 now proposed by the Board cannot be found in the statute. The Section prohibits "*any* person, firm, corporation, association, business trust, or other similar organization" (emphasis supplied) to engage simultaneously in commercial banking and the investment trust business. The provision is not limited to banks. So long as the entity that engages "to any extent whatever" in commercial banking also is engaged in the issuance, sale or distribution of securities to the public, the subject relationship is forbidden.

Surely the language employed by Congress in Section 21 is broad enough to deal with the evil feared. It strains credulity to suggest that the authors of Glass-Steagall would have been content to see their handiwork undone through the artifice of a layering of corporate entities that preserved a formal separation of commercial and investment banking while accomplishing their functional union.

The court below sustained the Board's contention that Section 21 does not apply to the activities of bank holding companies. Although agreeing "that the purposes of the Glass-Steagall Act are fully broad enough to encompass the activities of bank holding companies and their non-bank subsidiaries," the court held that the structure of the statute would not allow such an interpretation of Section 21. 606 F.2d at 1012 (Pet. App. 17a). The court viewed Sections 21 and 16 as dealing with converse situations. According to the court, Section 21 was designed to prohibit the investment banking houses from engaging in deposit bank-

ing, while Section 16 was designed to prohibit commercial banks from carrying on securities activities.

But Section 21 is far broader than Section 16, both in the nature of the activities prohibited and the variety of institutions covered. This Court recognized the distinction in *Camp,* when it found that the sponsorship of the mutual fund before it amounted not only to the bank's dealing in stock "for its own account," within the ban of Section 16, but additionally to an investment entity's "issuing" and "selling" stock or "other securities" while engaging in commercial banking, within the ban of Section 21. 401 U.S. at 625.

The court below also was influenced by the presence of Section 20, which dealt specifically with bank subsidiaries and siblings, and of Section 19, which dealt with bank holding company affiliates through the permit procedure. But the fact that Sections 19 and 20 collectively dealt with bank affiliates does not mean that those were the only Sections that could apply to such affiliates. By its terms, Section 21 was broader in its reach than Sections 19 and 20. In embracing the definitions of affiliates found in Sections 2(b) and (c), Sections 20 and 19 necessarily were limited in their reach to a certain extent, because they excluded from their coverage those affiliation relationships that did not happen to meet the percentage or control tests prescribed in Section 2. By contrast, Section 21 adopted no such percentage or control limitations. To that extent, it provided both a complementary and an expanded coverage.

Additionally, Section 19 was restricted in its scope by its disavowal of direct regulation of bank holding company affiliates as such, and its recourse to the less

direct route of regulating such affiliates' voting of their respective bank securities holdings. That approach left certain holding company affiliates free to continue to exercise functional control over their bank subsidiaries without formally voting their stock. That loophole was one of the considerations that influenced Congress to adopt the Bank Holding Company Act of 1956, discussed in this Brief in Part II. By contrast, Section 21 asserted a flat prohibition upon the commingling of commercial banking and investment trust functions, without regard to the issuance or nonissuance of voting permits.

Congressional recourse to the foregoing arrangement, in which Section 21 overlapped Sections 19 and 20 in part but also surpassed them in scope, is understandable. Congress was concerned that it might not have the constitutional power to assert its legislative authority to the full extent it wished. There was the risk that one or another Section of the Act might be held to exceed permissible constitutional limits. *See* S. Rep. No. 77, *supra,* at 10; 77 Cong. Rec. 4179 (remarks of Sen. Tydings) (1933). In that event, Congress did not want its legislative effort to go entirely for naught. The remaining provisions of Glass-Steagall presumably would ensure continued regulation of the banking industry.

In drafting Section 21 as a broad, comprehensive "catch-all" provision designed to round the corners of the complementary prohibitions contained in Glass-Steagall, Congress acted with foresight for the future. The modern one-bank holding company phenomenon generally has emerged from the creation of the holding company by the bank itself through the device of a "phantom merger." Typically the bank causes the

formation of its corporate parent and then passes its shares (often through merger with a third corporate entity of limited existence, specially formed for the purpose) to the parent while the parent's stock is distributed ratably among the bank's shareholders. *See, e.g., Banking,* vol. 41, 34 (Dec. 1968).[9] The Board's view that the holding company device lawfully may be used by a bank to circumvent the restrictions of Glass-Steagall Section 21 not only ignores economic realities, but is at odds with Congress' expressed objective of getting banks out of the securities issuing and marketing business.

The Board's refusal to consider the bank and its holding company as an economic unit for purposes of analysis under Section 21 contrasts tellingly with its other decisions under Glass-Steagall. The Board elsewhere has recognized the appropriateness of treating a holding company and its bank subsidiary as a single entity for purposes of Glass-Steagall Act Section 32. That provision, as noted above, prohibits officers, directors, and employees of any member bank from serving simultaneously in similar capacities with companies "primarily engaged in the issue, flotation, underwriting, public sale, or distribution . . . of . . . securities." In a 1969 case involving an interlocking relationship between a securities company and a bank holding company, the Board found:

> "[W]here the principal activity of a holding company is the ownership and control of banks, including one or more member banks, the holding company and each member bank subsidiary should be considered as constituting together a single entity

[9] Nine of the 10 banking institutions that sponsored the currently operating closed-end investment companies (see table, pp. 17-18 *supra*) are one-bank holding companies.

> for section 32 purposes, so that a person who is primarily engaged in section 32 business or associated with an organization so engaged is prohibited by that law from serving as an officer, director, or employee of such a holding company." 12 C.F.R. § 218.114(e); *see also id.* § 218.113.

The Board based its holding on the conclusion that to fail to apply the Section 32 restrictions to both the bank holding company and its subsidiaries would frustrate the objective of Congress:

> "[T]he affairs of the member bank and the holding company would be so closely identified and functionally related that the same possibilities of abuse which section 32 was designed to guard against would be present in the case of a director of the holding company as in the case of a director of the member bank . . . ." *Id.* § 218.114(d).

Similarly, in a 1963 decision, the Board found that Section 32 barred interlocking service as a bank director by an officer of a company that served as an investment adviser to two open-end investment funds, where it appeared that the adviser had been created for the purpose of serving the funds and stood in a close relationship of management and control over them. The Board concluded that notwithstanding their technically separate identities, the adviser and the fund must be regarded as the same entity. 12 C.F.R. § 218.-107.

The Board has applied the same rationale in response to a petition by the Securities Industry Association concerning the brokerage activities of Citicorp Person-to-Person Investments, Inc. ("CPPI") in connection with the sale of Citicorp notes. CPPI is a wholly owned subsidiary of Nationwide Financial Services Corpora-

tion, which itself is a wholly owned subsidiary of Citicorp, a bank holding company. The Board concluded that even if CPPI were itself engaged principally in activities that would violate Glass-Steagall Section 20, nonetheless the parent and subsidiary, viewed together, were not "principally" engaged in securities activities in violation of Section 20. Letter from Theodore E. Allison, Secretary of the Board, to Edward I. O'Brien, President, Securities Industry Association (Dec. 27, 1977). The Board found that CPPI was not "principally" engaged in securities activities because it constituted only a part of a holding company complex that in the aggregate was not principally engaged in securities activities in that it was engaged in banking activities.

Thus, contrary to its position now urged upon the Court, the Board has recognized that the application of both Sections 20 and 32 properly turns upon consideration of the bank holding company complex as a whole. The Board has not explained why the banking activities of a holding company complex similarly should not be imputed to a nonbanking subsidiary for purposes of enforcing the restrictions of Section 21.

B. The Absence of Bank Industry Sponsorship of Closed-End Investment Companies Demonstrates the Contemporaneous and Continuing Understanding of the Statutory Prohibition

The banking community well understood the significance of the Glass-Steagall Act insofar as its former association with securities marketing was concerned. Only after promulgation of the Regulation here under challenge did banking institutions—including banks as well as bank holding company affiliates—again involve themselves in the issuance and marketing of securities.

So far as can be determined from the publicly available materials, it appears that banks and their affiliates in the years immediately following the enactment of Glass-Steagall disappeared from securities marketing, with at most a handful of possible exceptions. According to a report prepared by the Securities and Exchange Commission staff in 1938, as of the end of 1935 there were no bank affiliates or commercial bank and trust companies involved in the sponsorship of open-end investment companies. *SEC Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 59 (1939). As for bank involvement in closed-end companies, the SEC Report said:

> "[One of t]he most striking changes in the sponsorship of closed-end companies within the period 1929 and 1935 [was] . . . the disappearance of national bank security affiliates as sponsors *because of the abolition of such affiliates by the Banking Act of 1933.*" *Id.* (emphasis supplied).

See Camp, 401 U.S. at 629.

In its brief to the Court here, the Board points to a reference in the same SEC Report to the effect that as of the end of 1935, banks and trust companies were said to be the sponsors of some 12 closed-end companies. SEC Report at 58, *cited in* Pet. Br. 34 n.26, 55. The Board's reliance upon this passage is misplaced. The SEC Report admittedly used the term "sponsored" in a loose sense, acknowledging:

> "The term sponsor is generally used in this chapter to describe the organizer, the firm which was the originating banker for the securities of the investment company, or the dominant management group. For the purposes of this section, the apparent dominant management group was con-

> sidered the sponsor *because it was impossible in many cases to identify the original organizers of the companies.*" *Id.* at 56 (emphasis supplied).

The Board asserts that banking organizations continued to sponsor and organize closed-end investment companies following the enactment of Glass-Steagall (Pet. Br. 34 n.26, 55). That is not correct. The SEC Report makes clear that sponsorship of closed-end funds and sale of their securities practically ceased shortly after the 1929 market crash:

> "New capital in the investment company field from 1927 through 1929 was raised largely by the sale of securities of closed-end companies, that is, by closed-end management investment companies proper and management investment-holding companies. By far the largest number of closed-end management investment companies in existence at any time were organized prior to the end of 1929, and practically all of them were formed prior to the end of 1930. . . . *The sale of the securities of closed-end management investment companies* proper and management investment-holding companies *declined sharply in 1930 and practically ceased thereafter,* although at the end of 1936 these groups still possessed nearly 75% of the assets of the industry." SEC Report (Part 3), at 4 (footnotes omitted) (emphasis supplied).

In all likelihood, therefore, the 12 closed-end funds in existence in 1935, identified in the SEC Report as sponsored by commercial banks and trust companies and now pointed to by the Board (Pet. Br. 34 n.26, 55), were the same 12 funds that were in existence in 1929 and that were identified as sponsors at that time. In other words, those funds were sponsored at least three years *prior* to the Glass-Steagall prohibition.

Following the enactment of Glass-Steagall and the disappearance of bank-sponsored investment companies, broker-dealer sponsorship of such companies emerged as the primary source of such securities marketing activities. According to the SEC Report, *supra,*

> "By the end of 1935, open-end companies had $356,000,000 or 24% of the total assets of all management investment companies proper. *This rapid growth was characterized by the rise in the importance of brokers and dealers as sponsors of these companies.* At the end of 1935, this type of sponsor dominated 17 companies with total assets of $191,000,000 as compared with five companies with total assets of $37,000,000 at the end of 1929. Investment counsel, etc., who were the sponsors of 10 open-end companies at the end of 1929, over half of the then total number, were the sponsors of 15 such companies with total assets of $79,000,000 at the end of 1935. Of the remaining seven open-end companies, two were sponsored by houses of issue, two by individual capitalists and promoters, two by other sponsors, and one by mixed sponsors." *Id.* at 59 (emphasis supplied).

Thereafter, banking institutions remained separated from the investment company business, including their holding company affiliates, until the Board's adoption of the Regulation that is here under challenge. The continued absence of banking industry sponsorship of closed-end investment companies is reflected in the annual reports of Wiesenberger Investment Companies Service. Apart from the continued existence of such companies that had been organized by banking associations prior to the enactment of Glass-Steagall, the

Wiesenberger volumes are devoid of any suggestion of bank holding company sponsorship of investment companies, whether of the open- or closed-end variety, prior to the Board's 1971 Regulation.

A House Report published in 1955 contained a list of nonbanking organizations within the 18 holding company affiliate groups under regulation by the Federal Reserve Board as of 1953. H.R. Rep. No. 609, 84th Cong., 1st Sess. 10 (1955). Not one of the nonbanking organizations was an investment company. It could not have been shyness on the part of the bank holding companies that prevented them from setting up investment companies. As the court of appeals observed below, this is additional evidence that bank holding companies viewed the Glass-Steagall Act as prohibiting their involvement in the investment company business. 606 F.2d at 1017 n.32 (Pet. App. 29a).

Both the Board and its supporting *amici* rely on Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-10(c), as support for the proposition that closed-end investment companies were not barred from bank affiliation by Glass-Steagall (Pet. Br. 27-28 n.20; Am. Br. 28-30). Section 10(c) provides:

> "After the effective date of this title, no registered investment company shall have a majority of its board of directors consisting of persons who are officers or directors of any one bank: Provided, That, if on March 15, 1940, any registered investment company shall have had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such registered company may continue to have the same percentage of its board of directors consisting of

> persons who are directors, officers, or employees of such bank."

That provision does not advance the Board's case. It does not *permit* interlocking directors between banks and investment companies. It *forbids* an investment company to have a majority of directors who are also officers or directors of any one bank. It leaves the law of interlocking directors where it was under Section 32 of the Glass-Steagall Act. It is an outer limit on the permissible number of interlocking directors between any one bank and an investment company, whether or not the investment company is engaged in *any* issuance of securities, and no matter what role the bank played in the creation of the investment company.

The grandfather clause of the provision does not condone involvement of an officer or director of a bank in the creation of an investment company. To the contrary, the legislative history of the provision makes clear that the clause was meant only to allow one or two interlocking directorates to continue:

> "[T]here are one or two such situations which are still left, and we recommended that they be not disturbed, but that the relationship should not be permitted to be created in the future." *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 886 (1940).

It appears that the situations allowed to continue included one or two of the 12 closed-end companies that still were advised by banks in 1935 according to the 1938 SEC Report. *See* p. 71 *supra.* As noted above,

it is likely that these 12 closed-end companies were sponsored prior to Glass-Steagall.

C. The Regulation Cannot Be Saved by the Restrictions Contained in the Board's Interpretive Ruling

In an effort to salvage the Regulation from its patent inconsistency with the prohibitions of Glass-Steagall, the Board issued an accompanying Interpretive Ruling. That Ruling does not save the Regulation from a determination of invalidity, but plainly concedes that the evils sought to be prevented by Glass-Steagall are inherent in the Regulation.

Having in effect acknowledged that deficiency, the Ruling attempts, without success, to preclude—evidently by administrative urgings rather than fiat—some, but far from all, of the evils that the Glass-Steagall legislation was intended to prevent. However, it is inevitable that the activities authorized by the Board will give rise to many of the same potential hazards, conflicts of interest, and unsound banking practices that Congress attempted to eliminate in Glass-Steagall.

First, a major danger noted by this Court in *Camp* was that "[t]he bank's stake in the investment fund might distort its credit decisions or lead to unsound loans to the companies in which the fund had invested." 401 U.S. at 637. The ultimate fee derived by the holding company affiliate in all likelihood will be a percentage of the value of the fund's portfolio assets, which in turn will depend on the financial health of the portfolio companies. As the court of appeals ob-

served below, that danger is equally present in the case of closed-end funds sponsored and managed by bank holding companies. 606 F.2d at 1023 (Pet. App. 45a-46a). The Interpretive Ruling does nothing to alleviate this evil.

Second, in a bank holding company-sponsored closed-end fund, no less than in the open-end fund declared unlawful in *Camp,* there is the danger that "[t]he bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund." 401 U.S. at 637-38. For example, there is the risk that the subsidiary bank will disclose confidential information about its depositors to its affiliated investment adviser. 606 F.2d at 1023 (Pet. App. 45a). The Ruling leaves open the possibility of such abuse.

Third, a subtler danger perceived by the Court in *Camp* also applies with equal force to bank holding company-sponsored closed-end funds. The Court noted:

> "Imprudent or unsuccessful management of the bank's investment fund could bring about a perhaps unjustified loss of public confidence in the bank itself. If imprudent management should place the fund in distress, a bank might find itself under pressure to rescue the fund through measures inconsistent with sound banking." 401 U.S. at 637.

Along the same lines, the Court further observed:

> "If the fund investment should turn out badly there would be a danger that the bank would lose the good will of those customers who had invested in the fund. It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank. But because banks are dependent on

> the confidence of their customers, the risk would not be unreal." *Id.* at 638.

A similar concern was expressed as part of the legislative background to the enactment of Glass-Steagall, when it was said:

> "The bank is closely connected in the public mind with its affiliates, and should the latter suffer large losses it is practically unthinkable that they would be allowed to fail." *Hearings Pursuant to S. Res. 71, supra* at 1063 (App. Part VII).

To be sure, the Board's Interpretive Ruling purports to prohibit closed-end investment funds from using names similar to those of their bank or bank-affiliated advisers. 12 C.F.R. § 225.125(f). But it is disingenuous to suggest that Congress' fundamental concern to avoid public identification of an investment company with its bank sponsor can be remedied by such a simplistic device as prohibiting the use of a common name. Equally effective means of associating a bank with a sponsored fund in the public's mind are not prohibited under the terms of the Board's Ruling, such as the judicious use of the bank's name in the fund's promotional literature.

As a practical matter, there can be little doubt that bank sponsorship is publicly known. This is especially true in the case of those funds where such sponsorship is openly acknowledged, or where the funds and the banking complexes that advise them use the same logos. The Institute submitted evidence to the Board that banking institutions purporting to sponsor closed-end funds pursuant to the Board's Ruling already had entered into agreements that licensed the use of their logos to the sponsored funds (R. 338-50). Moreover,

in every case the prospectus filed by closed-end funds with the SEC must disclose the facts and circumstances concerning the fund's investment adviser. Much of the promotional literature capitalizes heavily on the names and reputations of the sponsor banks, fulfilling the Court's prediction in *Camp* that a "bank that operated an investment fund would necessarily put its reputation and facilities squarely behind that fund and the investment opportunity that the fund offered." 401 U.S. at 637. Thus, the same danger of undermining public confidence in banking institutions that was perceived by this Court in *Camp* is present in the case of closed-end funds sponsored by bank holding companies.

Fourth, another danger noted by the Court in *Camp* was that a bank engaged in advising an investment fund could find it difficult to give disinterested investment advice:

> "A bank that operates an investment fund has a particular investment to sell. It is not a matter of indifference to the bank whether the customer buys an interest in the fund or makes some other investment. If its customers cannot be persuaded to invest in the bank's investment fund, the bank will lose their investment business and the fee which that business would have brought in." 401 U.S. at 636.

Along those lines, the Court foresaw the danger that "[t]he bank might divert talent and resources from its commercial banking operation to the promotion of the fund," or "might make loans to facilitate the purchase of interests in the fund." *Id.* at 638. As Senator Bulkley put it during the Glass-Steagall debates:

> "Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise

> disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment of which the bank is to receive an originating profit or an underwriting profit *or a distribution profit or a trade profit or any combination of such profit.*" 75 Cong. Rec. 9912 (1932) (emphasis supplied).

Similar concerns were expressed on the floor of the House. *See* 77 Cong. Rec. 4028 (remarks of Rep. Fish) (1933).

These dangers also are present in the case of closed-end funds sponsored and controlled by bank holding companies, at the time of the initial sale and again upon any subsequent sale of fund shares. The bank member of a bank holding company complex sponsoring such a fund will be tempted to encourage customers seeking investment advice at the time of the fund's initial offering (or at the time of any subsequent offering) to buy into its holding company's investment company. The Justice Department expressed a like concern to the Board in its submission below (A. 15).

The bank has an obvious incentive to promote the success of the initial offering of the closed-end fund securities, both because of the public identification of the bank and its sponsored fund (and the consequent wedding of their good will and fortunes) and because the starting size of the fund will determine the baseline of the bank holding company's fees, which are tied to net asset value. The Board's Ruling, calling upon employees to abjure favoritism in their investment advice to bank customers, blinks at the reality of the situation.

A related concern was voiced in the legislative materials preceding enactment of Glass-Steagall, where it was pointed out that "in the case of a trust company or a bank with a trust department, the possession of a security affiliate may adversely affect the independence with which fiduciary activities are exercised." *Hearings Pursuant to S. Res. 71, supra* at 1034.

Finally, the Board's Regulation may lead to undesirable fluctuations in the value of the securities of the bank itself or of its holding company if publicly traded; also, to a tendency on the part of the bank to make unwise loan commitments in the knowledge that in case of need those commitments can be shifted to the investment company portfolio and thus removed from the bank's statement of condition. Significantly, concerns of this order, which are not addressed in the Board's Interpretive Ruling, were voiced nearly 50 years ago. *See Hearings Pursuant to S. Res. 71, supra.*

There can be no question that the challenged Regulation creates the potential for abuse. The Board has conceded that "potential conflicts of interest . . . may exist" as a result of the activities that it has authorized. 12 C.F.R. § 225.125(g). The Board may have sought to blunt such conflicts of interest by its Interpretive Ruling. But the restrictions there urged upon participants in the Board's securities program cannot mask the activities that have been, and will be, conducted under the aegis of its Regulation.

Of equal significance is the Board's studious disregard of the proper scope to be accorded the Glass-Steagall Act. The Board should strive to give full effect to Congress' intent, not to chip away at it. It is not the proper province of the Board to devise a regula-

tory regime that creates, rather than eliminates "potential conflicts of interest."

The Glass-Steagall Act as a whole should be followed with the thought that "[i]t is a preventive or prophylactic measure." *Board of Governors* v. *Agnew, supra,* 329 U.S. at 449 (discussion of Section 32); *cf. ICI* v. *Camp, supra,* 401 U.S. at 639. The legal restrictions of Glass-Steagall cannot be vitiated by the Board's adoption of rules for bank investment advisory activities that permit bank and bank affiliate sponsorship of closed-end investment companies. Absent congressional delegation of authority to the administrative agency, conduct made illegal by statute cannot be rendered lawful by the agency's issuance of regulations declaring the activity acceptable under certain circumstances. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 213-14 (1976); *Dixon* v. *United States,* 381 U.S. 68, 75 (1965); *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134 (1936).

Contrary to the Board's present suggestion (Pet. Br. 5 n.7), it cannot automatically be assumed under the current statutory regime that involvement of the banking industry in the securities business will proceed under the watchful eye of competent regulatory authorities. Where the holding company proposes to proceed by the *de novo* establishment of a subsidiary investment company, no application to the Board is necessary; instead, the holding company may proceed simply by notice to an appropriate Federal Reserve bank, followed by a brief waiting and comment period. 12 C.F.R. § 225.4(b) (1980).

One may not assume with confidence that the Comptroller of the Currency and the Federal Reserve Board,

the principal federal regulatory agencies for banking institutions, have any expertise or authority in the securities area. The reason for their lack of familiarity with the subject is apparent. Congress never contemplated that banking institutions would be active in the investment company industry. As a result, important regulatory gaps undoubtedly will emerge if the banks are permitted to move into the area.

CONCLUSION

For the foregoing reasons, the Investment Company Institute, respondent herein, respectfully submits that the judgment of the court of appeals below should be affirmed.

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APPENDIX

APPENDIX A

Bank Sponsorship of Closed-End Investment Companies

Banks commenced advisory relationships with the following closed-end funds after the promulgation of the Board's Regulation and Ruling: Advance Investors Corporation—advised by First National City Bank (New York) (now "Citibank, N.A."); Ben Franklin Income Securities, Inc.—advised by Girard Trust Bank (Philadelphia); Bunker Hill Income Securities, Inc.—advised by Security Pacific National Bank (Los Angeles); Circle Income Shares, Inc.—advised by American Fletcher National Bank & Trust Company (Indianapolis); Excelsior Income Shares, Inc.—advised by a wholly-owned subsidiary of United States Trust Company of New York (New York); Fort Dearborn Income Securities, Inc.—advised by First National Bank of Chicago (Chicago); Hatteras Income Securities, Inc.—advised by North Carolina National Bank (Charlotte); Independence Income Securities, Inc.—advised by Provident National Bank (Philadelphia); Invesco Equity Fund, Inc.—advised by Citizens and Southern National Bank (Atlanta); Meridian Income Securities, Inc. —advised by Indiana National Bank (Indianapolis); Municipal Fund of America—advised by Provident National Bank (Philadelphia); Overland Income Securities, Inc.—advised by Wells Fargo Bank, National Association (San Francisco); Pacific American Income Shares, Inc.—advised by a wholly-owned subsidiary of United California Bank (Los Angeles); Temporary Investment Fund, Inc.—advised by Provident National Bank (Philadelphia); and Cardinal Income Securities, Inc.—advised by First Union National Bank of North Carolina (Charlotte). *See* R. 351-2169.

The SEC registrations of several of the above funds—including Ben Franklin Income Securities, Inc.; Hatteras Income Securities, Inc.; Meridian Income Securities, Inc.; Overland Income Securities, Inc.; and Cardinal Income

Securities, Inc.—were withdrawn or never became effective. However, the original registration statements entered into the administrative record for the investment companies no longer in existence demonstrate the pattern and nature of bank involvement in the securities industry purportedly pursuant to the challenged Regulation. Accordingly, they remain relevant to the issues presented here.

In some cases, bank sponsorship of closed-end investment companies was freely admitted.[1] Even where sponsorship was not expressly admitted, strong indicia of sponsorship point to the conclusion that the relevant closed-end funds in fact have been sponsored by their bank advisers. The record portrays banks actively engaged in the creation and sponsorship of stock funds, as well as arranging for the underwriting and public sale of the securities issued by those funds (R. 338-2169). In each case, the bank undertook the advisory relationship at the outset of the existence of the closed-end fund, before any fund securities issued or were offered for sale, and well before the commencement of fund operations. To facilitate the initial issuance and sale of the closed-end fund's securities, eight banks originally agreed to indemnify the underwriters participating in the sale of shares against certain liabilities under the Securities Act of 1933 (R. 373, 675, 950, 1071, 1123, 1465, 1547, 1864). All of the bank-advised closed-end funds made provision in their corporate documents for authorization of additional shares to be issued, and at least two

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[1] These include express admissions of sponsorship in Item 13 of the Form N-8B-1 filings of Overland Income Securities, Inc. (admitting sponsorship by Wells Fargo Bank, N.A.) and Excelsior Income Shares, Inc. (admitting sponsorship by wholly-owned subsidiary of United States Trust Company of New York). In the words of counsel who represented Citibank, adviser to Advance Investors Corporation (which originally was organized as a closed-end fund and subsequently converted into an open-end fund), "it is fair to say that Citibank participated in the initial sponsorship and organization of Advance" (R. 3099).

of those funds initiated such new issues (R. 2801-914). Additionally, most of the companies adopted some form of dividend reinvestment plan, whereby periodic dividends may be used for continuous purchases of additional shares of each company's stock (R. 369, 423, 486, 579, 669, 946, 1023). At least one bank undertook an advisory relationship to more than one closed-end fund (R. 1111-67, 1533-1600).

All the bank advisers of closed-end funds were empowered to manage the investment operations of the companies served. The banks not only were authorized to make the investment decisions, but also to place purchase and sale orders, select the broker-dealers, and perform a variety of other administrative functions. In almost all cases, extensive interlocking relationships proliferated between directors, officers, or employees of the closed-end fund and the adviser bank. The vast majority of officers and employees were common to both the adviser and the fund, as were a minority of fund directors in most cases (R. 364, 419-20, 482-83, 577-78, 667-68, 838, 943, 1028-29). In a number of instances, banks undertook to bear certain excess operating costs incurred by the funds (R. 365, 484, 575, 665, 840, 945). In at least one case, a bank agreed to bear the expenses of organizing and incorporating the fund (R. 664). In some cases, banks agreed to perform the functions of custodian or transfer agent or both for the funds (R. 372, 426, 846, 951).

In each case, of course, the bank was to be compensated for its service. Although the rates varied somewhat, the usual advisory fee provided for was 0.5 percent of the fund's net asset value, computed periodically (typically on a monthly basis). This procedure tied the advisory fee to the fund's performance. In the case of at least one fund—Peachtree Equity Securities, Inc.—this relationship was made even more explicit. Peachtree adopted an elaborate fee computation system under which the base fee payable to its ad-

viser (a wholly-owned subsidiary of a national bank) would increase or decrease in accordance with the performance of Peachtree's portfolio securities relative to the Standard & Poor's Index of 425 Stocks. Peachtree Equity Securities, Inc. technically constituted an open-end fund, as defined in Section 5(a)(1) of the Investment Company Act of 1940, 15 U.S.C. § 80a-5(a)(1), because its shares were redeemable at net asset value at any time.

Thus, the banks that commenced advisory relationships with closed-end funds after the promulgation of the Board's Regulation and Ruling plainly sponsored those funds.

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OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

v.

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE PETITIONER

1. Respondent's brief confuses both the scope of the activities authorized by the Board's regulation and the legal basis for the Board's action.[1] It therefore may be useful at the outset to summarize the activities that have been authorized by the Board and to set forth once again the basic elements of the statutory scheme.

a. Although respondent's brief may leave a different impression, neither a bank holding company nor any of its subsidiaries operating in the manner authorized by the Board's regulation would hold an equity interest in a closed-end investment company, participate in market-

[1] The Board's regulation and interpretive ruling permit a bank holding company or its non-bank subsidiary to render investment advice to and, subject to appropriate safeguards and restrictions, also to organize, sponsor, manage and control a closed-end investment company. 12 C.F.R. 225.125(c)-(i). Rendering investment advice to investment companies is an appropriate activity for a bank holding company, and respondent does not contend otherwise. Pet. App. 8a n.13. The dispute here therefore concerns solely the propriety of a holding company's organization, sponsorship, management and control of a closed-end investment company.

ing the investment company's securities to the public, or otherwise assume any financial risks with respect to the operations of the investment company. A bank holding company desiring to "sponsor" a closed-end investment company pursuant to the Board's regulation normally would proceed by creating an investment advisory subsidiary and filing with the Board a notice of its proposed operations. If the Board did not object within 45 days (see 12 C.F.R. 225.4(b)(1)), the subsidiary next would have to register as an investment adviser with the Securities and Exchange Commission pursuant to Section 203(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(a). The subsidiary would then arrange for the incorporation of a separate investment company, and the new investment company would register its shares with the Commission. See 15 U.S.C. 77e and 77f; see also 15 U.S.C. 80a-8. The investment company then would sell its shares to independent underwriters, who at their own risk would resell the shares in a public offering.[2] Thus, neither the bank holding company nor its investment advisory subsidiary would have any involvement in any promotional activities incident to public distribution of the investment company's shares.

Following the investment company's sale of its securities to the underwriters, the relationship of the bank holding company and its subsidiaries to the investment

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[2] Neither the bank holding company nor any of its subsidiaries could serve as the underwriters. The Board's interpretive ruling expressly prohibits bank holding companies and their subsidiaries from engaging "directly or indirectly, in the sale or distribution of securities" issued by an investment company advisee. 12 C.F.R. 225.125(h). The underwriting must therefore be performed by an independent investment banking firm, as it was in each of the instances cited by respondent (Br. 17-18) in which banking organizations have managed closed-end investment companies. The registration statements of those investment companies confirm that their securities were distributed to the public by independent underwriters, not by banking organizations. See the Appendix attached to this brief.

company would be limited to investment advisory services, *i.e.*, portfolio management and related administrative services, the same services provided to any other investment company by its investment adviser. The investment company would even be free to replace the investment advisory subsidiary with a new investment adviser. 15 U.S.C. 80a-15(a), (c).

In sum, a bank holding company "organizes" or "sponsors" a closed-end investment company simply by participating in the initial establishment of the investment company. At no time during that process is the bank holding company or its bank or nonbank subsidiaries a promoter of, or at risk with respect to, the investment company's securities. In particular, the Board's regulation forbids promotional, speculative, and lending activity that could imperil the financial soundness of any bank subsidiary. See 12 C.F.R. 225.125(f)-(i). There is no more risk of financial loss, or risk of loss of public confidence, than when a bank organizes and furnishes investment advice to a common trust fund in accordance with traditional banking practice.[3]

b. The statutory framework within which the Board acted in authorizing bank holding companies to sponsor closed-end investment companies is prescribed by the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*, and the Banking Act of 1933 (Glass-Steagall Act), ch. 89, 48 Stat. 162. The provisions of these statutes are straightforward, and they clearly distinguish between banks, on the one hand, and bank holding companies and other affiliates of banks, on the other.

Section 4(a) of the Bank Holding Company Act, 12 U.S.C. 1843(a), prohibits a bank holding company and its subsidiaries from engaging in any business other than banking or managing or controlling banks. Section 4(c)(8) of that Act, 12 U.S.C. 1843(c)(8), however, empowers the Board to authorize bank holding companies

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[3] See *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306, 307-309 (1950); 12 C.F.R. 9.18.

and their non-bank subsidiaries also to engage in non-banking activities that the Board determines to be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." It is pursuant to Section 4(c)(8) that the Board promulgated the regulation challenged by respondent in this case.

Respondent's arguments against the Board's regulation, however, center not upon the Bank Holding Company Act but upon Sections 16, 20, and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, 377, and 378. Of these three provisions, only Section 20 is applicable to bank holding companies. Section 20 prohibits bank "affiliates," including bank holding companies and their nonbank subsidiaries, from "engag[ing] principally in the issue, flotation, underwriting, public sale, or distribution * * * of * * * securities."

Section 21 of the Act does not by its terms apply to bank holding companies. It simply prohibits persons engaged in "the business of receiving deposits," *i.e.*, banking, from engaging at the same time in "the business of issuing, underwriting, selling, or distributing * * * [nongovernmental] securities." Section 16 similarly concerns only banks. It provides that banks may not underwrite any issue of nongovernmental securities and that a bank may purchase and sell securities, other than governmental securities and a limited category of other securities, "solely upon the order, and for the account of, customers, and in no case for its own account."

2. Respondent's opening argument (Br. 13-18) rests on a fundamental misunderstanding of the Board's regulation and the statute under which it was promulgated. Respondent contends that the regulation authorizes banks, as well as bank holding companies and nonbank subsidiaries, to manage closed-end investment companies. But as the Board has clearly stated, the regulation authorizes activities only on the part of bank holding companies and their nonbank subsidiaries (Pet. App. 61a, 67a). The Board's interpretation of its own regulation

is consistent with the Bank Holding Company Act and was properly upheld by the court of appeals (Pet. App. 21a-23a). See *United States* v. *Larionoff*, 431 U.S. 864, 872 (1977) (an agency's interpretation of its own regulation is entitled to "controlling weight" unless plainly erroneous).

The regulation at issue was promulgated by the Board pursuant to Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), which empowers the Board to authorize bank holding companies and non-bank subsidiaries—not banks—to engage in activities that the Board determines are "so closely related to banking * * * as to be a proper incident thereto." Section 4(c)(8) does not empower the Board to approve or disapprove any business activities of banks. The authority of a bank to engage in a particular activity is determined by the bank's charter and the statute under which the bank is organized. See *Colorado National Bank* v. *Bedford*, 310 U.S. 41, 48 (1940).[4] As the Board explained (Pet. App. 61a), that authority "does not derive from the Board's regulation; such authority would exist independently of the Board's regulation and its scope is to be determined by a particular bank's primary supervisory agency."

Moreover, the Board's regulation does not purport to authorize activities for banks. The challenged regulation adds investment advisory services to the list of activities that the Board previously had approved for a "bank holding company" (see 12 C.F.R. 225.4(a)). While it is

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[4] The governing statute for national banks is the National Bank Act, 12 U.S.C. 21 *et seq.*; state banks derive their powers under state law. In denying respondent's petition for rescission of the Board's regulation, the Board stated, in its capacity as the federal regulator of state-chartered banks that are members of the Federal Reserve System, that should a state member bank engage in the same activity authorized for a bank holding company by the Board's regulation, such activity would not violate Sections 16 and 21 of the Glass-Steagall Act and would be permissible if consistent with applicable state law. The Board made clear, however, that the regulation at issue in this case does not authorize any activities for banks (Pet. App. 60a-61a, 66a-70a).

true that the interpretive ruling (which prescribes limitations on the activities of bank holding companies serving as investment advisers) defines "bank holding companies" to include "both their bank and nonbank subsidiaries" (12 C.F.R. 225.125(c)), the interpretive ruling does so simply to establish that the *restrictions* set forth in the ruling apply to all companies in the holding company system. The interpretive ruling itself authorizes no activities. As the Board explained, it serves solely to limit the activities that are authorized by the accompanying regulation (see Pet. App. 22a-23a, 61a). The definition of "bank holding companies" thus serves to prevent evasion of the restrictions prescribed by the Board through a shifting of prohibited activities to a subsidiary bank, but neither the definition nor any other aspect of the Board's regulation authorizes banks themselves to engage in any activities.

Respondent's argument to the contrary (Br. 14) appears to rest on the fact that, following promulgation of the Board's regulation, a number of banks have participated in the sponsorship of closed-end investment companies. Those banks did not, however, seek or obtain authorization from the Board. See Pet. App. 22a-23a n.26. As the record in this case shows, the Board has not been asked to grant approval (and could not grant approval) for any bank to serve as an investment adviser to an investment company (R. 2262-2266; Pet. App. 67a n.1).[5]

3. In focusing principally upon the activities of banks rather than bank holding companies and their non-bank

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[5] Of the 10 banking organizations cited by respondent (Br. 17-18), only two are engaged in management of closed-end investment companies pursuant to the Board's regulation. BankAmerica Corporation and Western Bancorporation, which are bank holding companies, currently conduct these activities through non-bank subsidiaries. The registration statements relied on by respondent (Br. 15) do not suggest that any banks have organized or managed closed-end investment companies pursuant to the Board's regulation. See R. 418, 485, 666, 1660, 1767.

subsidiaries, respondent evidently hopes to force this case into the mold of *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). But in its eagerness to characterize *Camp* as "controlling authority" (Br. 23), respondent ignores the manifold differences between the two cases.

The issue in *Camp* was whether, under Sections 16 and 21 of the Glass-Steagall Act, a bank could issue and distribute interests in a collective investment fund that was administered internally by the bank and operated in the same manner as an "open-end" investment company or "mutual fund." 401 U.S. at 625. The bank operating the fund was engaged regularly and continuously in issuing and selling units of participation "evidencing an undivided and redeemable interest in the assets of the fund." [6] *Ibid.* Thus, the bank acted as "the underwriter of the fund's units of participation." *Id.* at 622-623, 636-638.

Application of the Glass-Steagall Act to those facts required resolution of only one narrow issue. Section 16 of the Glass-Steagall Act prohibits a bank from underwriting any issue of "securities." Section 21 of the Act similarly prohibits any person engaged in the business of issuing, underwriting, selling, or distributing "securities" from also engaging in deposit banking. Accordingly, the question to be decided in *Camp* was whether "participating interests in * * * a [collective investment] fund are * * * 'securities' within the meaning of the Act." 401 U.S. at 634. After reviewing the legislative history and statutory objectives, this Court determined that "the purposes for which Congress enacted the Glass-Steagall Act leave no room for the conclusion that a participation in a bank investment fund is not a 'security' within the meaning of the Act." *Id.* at 635-636.

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[6] A closed-end investment company is not similar to the commingled managing agency accounts considered in *Camp*. Unlike managing agency accounts, assets are contributed to a closed-end company only at its initial organization and on infrequent occasions thereafter, and cannot be withdrawn except upon liquidation of the company.

This case differs fundamentally from *Camp*. Violations of Sections 16 and 21 of the Glass-Steagall Act were found in *Camp* because the bank itself engaged in public distribution of the fund's securities and in the business of issuing, redeeming, and selling those securities. In contrast, no bank is authorized by the Board's regulation to engage in those activities. Nor is any bank holding company or subsidiary authorized to do so.

The Board has forbidden bank holding companies and their subsidiaries, including banks (see page 6, *supra*), from engaging, "directly or indirectly, in the sale or distribution of securities of any investment company for which [they act] as investment adviser." 12 C.F.R. 225.125(h). Thus, no bank or any other company in the holding company structure may underwrite the shares of an investment company. Nor does any company in the holding company structure otherwise create or maintain a market for the investment company's shares. Neither the bank holding company nor its subsidiaries would issue the shares of the investment company; as a separate corporate entity, the investment company issues its own shares. Moreover, the bank holding company and its subsidiaries are prohibited from buying or selling shares of the investment company for their own accounts. 12 C.F.R. 225.125(g). In short, the Board's regulation does not authorize banks, or bank holding companies, or their non-bank subsidiaries, to engage in any of the activities held unlawful in *Camp*. And because the promotional activities at issue in *Camp* are not present here, the dangers identified in *Camp* as arising when banks engage in such activities are not present either.

4. Resolution of respondent's Glass-Steagall Act challenge to the Board's regulation merely requires this Court to apply the literal terms of Section 20 of the Act, 12 U.S.C. 377, which draws the line between permissible and impermissible securities activities of bank "affiliates." [7]

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[7] Bank holding companies and their non-bank subsidiaries are "affiliates" subject to the restrictions of Section 20. As explained

Section 20 prohibits "affiliates" of banks from "engag-[ing] principally" in the issuance, flotation, underwriting, public sale or distribution of securities.

Respondent has wholly failed to demonstrate how a closed-end investment company advisee may be said to engage "principally" in the issuance or distribution of securities under the Board's regulation. "[A] closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. 225.125(c).[8] Virtually by definition, therefore, such an investment company is not "engaged principally" in the issuance or distribution of securities, which is all that Section 20 prohibits. Moreover, the Board's regulation permits bank holding companies to sponsor and advise only closed-end investment companies that are not "primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. 225.125(f).

Similarly, a bank holding company or nonbank subsidiary that manages a closed-end investment company pursuant to the Board's regulation would not violate Sec-

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in our opening brief (Br. 24-27), the Court need not decide whether an investment company advisee is also a bank "affiliate" for purposes of Section 20, since a closed-end investment company operating pursuant to the Board's regulation could not, in any event, infringe the standard prescribed by Section 20.

[8] Respondent argues (Br. 23-32) that there is no meaningful distinction between open-end and closed-end investment companies under Sections 16 and 21 of the Glass-Steagall Act. This argument is completely beside the point, for the distinction is fundamental in applying Section 20 of the Act. A closed-end company issues its shares only infrequently and is therefore not engaged "principally" in the issuance of securities. By contrast, an open-end investment company issues its shares continuously and is properly viewed, under the literal terms of Section 20, as an entity "principally" engaged in securities issuance. See Pet. App. 76a-77a. See also *SEC Report on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 41-43 (1966); *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 707 (Pt. 1), 75th Cong., 3d Sess. 26-27 (1938); *SEC Report of Special Study of Securities Markets*, H.R. Doc. No. 95 (Pt. 4), 88th Cong., 1st Sess. 97 (1963).

tion 20. The adviser, of course, does not issue the investment company's securities, and under the Board's regulation and interpretive ruling the adviser is completely segregated from the underwriting process. Accordingly, the investment adviser's activities, limited by the Board's regulation, cannot be characterized as "principal" engagement in the issuance or distribution of securities.[9] Respondent's contrary interpretation would effectively delete the "engaged principally" standard from the statute, in violation of the elementary principle of statutory interpretation that every phrase in a statute must be given effect. See *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).[10]

Respondent's argument under Section 20 appears to rest on the claim (Br. 62) that the mere issuance of shares at the outset of the closed-end investment company's business constitutes "engag[ing] principally" in the issuance or underwriting of securities. Respondent asserts that the " 'principal engagement' takes place at the time of the initial offering, when the distribution of the securities is the *only* activity of the entity" (*ibid.*; emphasis in original). This argument is wholly without

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[9] A bank holding company investment adviser may not manage a closed-end investment company that issues shares after its initial organization if this results in the closed-end investment company issuing shares on a frequent basis. 12 C.F.R. 225.125(f). If a bank holding company sought to evade this restriction by converting a closed-end company to an open-end company after its formation, such activity would be subject to supervisory restraint. In any event, as the Board explained (Pet. App. 69a-71a, 78a-79a), respondent's references (Br. 30-31) to such hypothetical questions are not relevant in determining the facial validity of the Board's regulation. Those issues can be addressed in future adjudicatory proceedings in which the Board is called upon to apply the regulation to specific facts.

[10] We also note that the Board's regulation goes substantially further than is required to assure compliance with Section 20. The Board has barred *all* involvement by bank holding companies in the security underwriting and distribution process, and has not limited its prohibition to "principal" engagement in underwriting. 12 C.F.R. 225.125(h).

merit. All corporations issue shares at the outset of business. This is true of banks, bank holding companies, and any bank affiliate organized in corporate form.[11] If respondent's argument were correct, every corporation would be "engaged principally" in the issuance of securities and therefore debarred from affiliation with a bank simply by virtue of its initial issuance of stock. In other words, respondent's argument points to the plainly incorrect conclusion that, contrary to the fundamental premise of Section 20 of the Glass-Steagall Act and Section 4(c)(8) of the Bank Holding Company Act, a bank could not have corporate affiliates of any kind.

5. In apparent recognition of the weakness of its legal position under Section 20 of the Glass-Steagall Act, respondent also argues (Br. 62-69) that a bank holding company that manages a closed-end investment company infringes Section 21 of the Act, 12 U.S.C. 378. Both the court of appeals (Pet. App. 14a-21a) and the Federal Reserve Board (*id.* at 54a-56a) correctly rejected that contention.[12]

Section 21 forbids any "person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing * * * or distributing * * * securities" from engaging "at the same time * * * in the business of receiving deposits * * *." Thus, by its terms, Section 21 applies only to *deposit receiving* institutions (such as banks), and not to bank holding companies or nonbank subsidiaries, which by definition do not engage in the business of receiving deposits.[13]

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[11] Both Congress and this Court have recognized the necessity for maintaining adequate capital in banking organizations. See *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250-251 (1978).

[12] Respondent does not contend that Section 16 of the Act, 12 U.S.C. 24 Seventh, applies to the activities of bank holding companies. See Pet. App. 21a. Section 16, on its face, applies only to banks.

[13] Senator Glass, the framer of the Act, stated that Section 21 was aimed at investment banking firms that also conducted an

The structure of the Glass-Steagall Act further demonstrates the inapplicability of Section 21 to bank holding companies. Section 20 of the Act specifically governs the securities activities of bank affiliates, and by definition the term "affiliate" includes bank holding companies and their non-bank subsidiaries. 12 U.S.C. 221a(b). Section 20 prescribes restrictions that are less stringent than those contained in Section 21. Thus, Section 20 bars bank affiliates only from engaging "principally" in the issuance or distribution of securities, whereas Section 21 more broadly prohibits banks from engaging at all "in the business of issuing, underwriting, selling, or distributing * * * securities." To apply the more sweeping prohibitions of Section 21 to bank affiliates would override Congress' deliberate choice of the "engaged principally" standard for bank affiliates and would render Section 20 a nullity. As the court below correctly determined, the distinctions drawn by Congress between banks and bank affiliates, and the congressional decision to apply different statutory standards to different entities within the holding company structure, are "convincing evidence that Congress rejected a 'single entity' theory in favor of a more discriminating approach to the problem" (Pet. App. 20a). See also *Board of Governors* v. *Agnew*, 329 U.S. 441, 447-448 (1947).[14]

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in-house deposit banking business. See 77 Cong. Rec. 3730 (1933); Pet. App. 17a-18a n.19.

[14] When Congress has enacted a specific statutory standard governing the securities activities of bank affiliates—as it has in Section 20—there is no need to search for standards in provisions of the Act that deal only with banks. When, however, the Act lacks standards specifically designed to cover the activities of bank affiliates in particular areas, it may be appropriate to extend the application of Glass-Steagall prohibitions to prevent evasion of the Act's purposes. Thus, as respondent notes (Br. 67-68), the Board has applied the requirements of Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, to bank holding companies as well as banks, because the Glass-Steagall Act contains no provision governing management interlocks between bank holding companies and investment banking firms. That interpretation does not suggest that differences in the

Finally, even if Section 21 were applicable to bank holding companies, it would not forbid a bank holding company from sponsoring a closed-end investment company within the limitations prescribed in the Board's regulation. The Board's regulation flatly forbids bank holding companies (as well their bank and nonbank subsidiaries) to engage "in the business of issuing, underwriting, selling, or distributing" the shares of investment companies. See note 10, *supra*. In short, the Board's regulation prescribes a prophylactic rule that prohibits bank holding companies to engage in the same activities that are prohibited to banks under Section 21. See pages 19-20, *infra*.

6. Respondent's arguments throughout appear to proceed from the underlying premise that the Glass-Steagall Act was intended to prohibit banks and bank holding companies from engaging in any form of the "securities" business. This inaccurate premise reveals a fundamental misapprehension of the nature of the limitations imposed by the Glass-Steagall Act.

a. Consistent with the provisions of the Glass-Steagall Act, banks traditionally have engaged in a broad spectrum of securities activities. As noted in our opening brief (at 55-56), banks are extensively involved in the

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separate statutory standards prescribed by Congress to regulate the securities activities of "banks" and "bank affiliates" should be disregarded. Nor is the other Board ruling cited by respondent (Br. 69) inconsistent with the Board's regulation here. That ruling did not hold that a bank holding company or its non-bank subsidiaries should be subjected to the requirements of Section 21 of the Glass-Steagall Act. The activities there involved were those of a non-bank subsidiary, and were properly analyzed by the Board under Section 20 of the Act. The Board concluded, based on the particular facts before it, that the holding company parent and the subsidiary (which provided services only to the holding company) should be considered together in applying Section 20. The result was that the holding company and the subsidiary were found not to be "engaged principally" in the issuance of securities. In sum, none of the Board's prior decisions ignores the differences between the separate Glass-Steagall Act provisions applicable to banks and those applicable to bank affiliates.

business of portfolio management, purchasing and selling securities for fiduciary customers including common trust funds, pension trusts, and managing agency accounts. Banks also purchase and sell large quantities of "investment securities" for their own portfolios (see 12 C.F.R. Part 1), receive securities as collateral for loans, and serve as transfer agents and registrars for the securities of corporate customers. Moreover, Section 16 of the Act, 12 U.S.C. 24 Seventh, permits banks to act as dealers in and underwriters of "obligations of the United States [and] general obligations of any State or of any political subdivision thereof." The Act also leaves banks free to interlock with brokerage firms (see *Board of Governors* v. *Agnew*, *supra*, 329 U.S. at 446; 12 C.F.R. 218.1 n.1). As the Securities and Exchange Commission observed in its *Initial Report on Bank Securities Activities* 1 (Jan. 3, 1977):

> Banks historically have played a major role in securities activities and the securities markets. While the permissible range of bank securities activities was circumscribed by passage of the Glass-Steagall Act in 1933, that Act did not separate the business of commercial banking from all aspects of the securities business. Banks act as underwriters of, and dealers in, U.S. government and municipal securities, manage the investments of others as trustee and agent, and are actively involved in the handling of securities and in the settlement of securities transactions for broker-dealers, institutional customers and others.

Thus, the mere fact that a banking activity involves securities cannot be the touchstone for Glass-Steagall Act purposes. Resort to the specific rules prescribed by Congress is essential to determine if a given activity transcends the bounds of lawfulness.

b. Respondent's generalized arguments about statutory purpose also misconceive the legislative history of the Glass-Steagall Act. That history shows that, while Congress intended to place significant restrictions on certain

securities activities of banks, it recognized the necessity for greater liberality in dealing with bank affiliates.[15]

In contrast to the more stringent provisions applicable to banks (see pages 11-12, *supra*), Section 20 of the Glass-Steagall Act only prohibits affiliates from engaging "principally" in the issuance or underwriting of securities. The adoption of the more flexible standard in Section 20 was not inadvertent. The immediate forerunner of Section 20 (then numbered Section 18) in the Glass bill prohibited banks from having specified relationships with entities "engaged primarily in the business of purchasing, selling, or negotiating securities." S. 4115, 72d Cong., 1st Sess. (1932). That provision was considerably broader than its intended objective, which was the underwriting and speculative activities of bank securities affiliates. See *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess. 190, 231, 267 (1932). With this in mind, Eugene Meyer, then Governor of the Federal Reserve System, criticized the text of proposed Section 18:

> MR. MEYER * * * [I]t is impossible to classify absolutely all affiliates that deal in securities as wicked and vicious.
>
> SENATOR GLASS. We are not classifying all of them and we are not intending to reach all of them. * * *

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[15] There is no support in the legislative history of the Glass-Steagall Act for the argument that Congress meant to forbid banks or bank affiliates from serving as investment advisers to closed-end investment companies. The holding in *Investment Company Institute* v. *Camp*, *supra*, depended on the fact that the bank there in question engaged actively in underwriting securities, not on a general congressional purpose to sever all links between banks and investment companies of all kinds. As noted in our opening brief (at 55), commercial banks managed closed-end investment companies prior to (and after) the enactment of the Glass-Steagall Act. However, there is no indication in the legislative history that organization and management of such entities—as distinguished from investing bank assets in them or underwriting their shares—were meant to be forbidden to banks.

Senate Hearings, *supra*, at 393. Governor Meyer then suggested language more narrowly tailored to the specific legislative objective. He proposed a substitute provision that dealt only with "affiliates," as that term was used in Section 2(b) of the bill, and prohibited banks from affiliating with firms "engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail" of securities. *Id.* at 387-389, 391-394, 416-417. The Committee adopted Governor Meyer's suggestion and his proposal was enacted in Section 20 of the Act.[16]

7. Respondent's arguments under Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), are, at bottom, merely repetitions of its contentions under the Glass-Steagall Act. Respondent does not adopt the theories articulated by the court of appeals. Nor does it contest the Board's factual determination that sponsorship of a closed-end investment company is "closely related to banking." Instead, respondent contends (Br. 18-32, 41-44) that, as a matter of law, such sponsorship cannot be considered a "proper incident to banking or managing or controlling banks" under Section 4(c)(8). Respondent's argument that sponsorship of a closed-end

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[16] Respondent plainly errs in asserting (Br. 69-75) that banks ceased sponsorship and management of closed-end investment companies after enactment of the Glass-Steagall Act. The very report that respondent cites shows that banks continued to manage and act as the sponsors of at least 12 closed-end investment companies. *SEC Report on Investment Trusts and Investment Companies*, H.R. Doc. No. 70 (Pt. 2), 76th Cong., 1st Sess. 57-59, 124 (1939). Respondent apparently rules upon the fact that "bank securities affiliates," *i.e.*, bank-affiliated investment banking firms (see *id.* at 57 n.38), are shown as having terminated all sponsorship activities. That occurred, however, not because banks could no longer act as sponsors but because the Glass-Steagall Act, by severing the affiliate relationship between investment banking firms and commercial banks, had effectively eliminated "bank securities affiliates." In fact, Congress was aware of the continued sponsorship of closed-end investment companies by banks, and it explicitly approved the continuation of existing relationships in Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. 80a-10(c).

investment company by a *bank holding company* is impermissible under Section 4(c)(8) rests on the premise that such sponsorship by a *bank* would violate Sections 16 and 21 of the Glass-Steagall Act.

Respondent's fundamental premise—that banks may not manage closed-end investment companies within the restrictions prescribed by the Board—is both irrelevant and erroneous. It is irrelevant because bank holding companies may engage in a broader range of securities activities than banks under both the Glass-Steagall Act and the Bank Holding Company Act. It is erroneous because even banks may manage a closed-end investment company under the restrictions prescribed by the Board without infringing either Section 16 or 21 of the Glass-Steagall Act.

a. Section 4(c)(8) of the Bank Holding Company Act authorizes the Board to grant exemptions from Section 4(a) of the Act, a provision that otherwise would restrict bank holding companies solely to the business "of banking or of managing or controlling banks." Thus, the very purpose of Section 4(c)(8), a purpose that is apparent on the face of the statute, is to empower the Board to permit bank holding companies to engage in activities not permitted to banks. If bank holding companies were limited to the activities of banks, as respondent contends, Section 4(c)(8) would be meaningless.

Congress "fully recogniz[ed] that bank holding companies would be permitted to engage in activities that were precluded to a bank * * *." *Connecticut Bankers Ass'n* v. *Board of Governors*, No. 79-1554 (D.C. Cir. Feb. 7, 1980), slip op. 14. Sections 4(c)(6) and (7) of the Bank Holding Company Act, 12 U.S.C. 1843 (c)(6) and (7), permit bank holding companies to buy and sell equity securities, specifically including the securities of investment companies, for their own accounts, even though banks are barred from doing so by Section 16 of the Glass-Steagall Act.[17] Congress additionally un-

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[17] Moreover, as we demonstrated in our opening brief (at 42-43), Section 4(c)(7) of the Bank Holding Company Act permits a bank

derstood that other nonbanking activities might also be proper activities for bank holding companies; but rather than attempt to catalogue each such activity itself, Congress designated the Board as the "appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits." S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955).

Nothing in this statutory delegation requires the Board to restrict bank holding companies solely to activities permissible to banks under the Glass-Steagall Act. Respondent apparently relies upon the "proper incident" standard of Section 4(c)(8). But in deciding whether an activity is a "proper incident" to banking or managing or controlling banks, the Board is simply instructed by Section 4(c)(8) to weigh the advantages and disadvantages to the public that may be expected to result from the conduct by a bank holding company of the activity in question:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public * * * that outweigh possible adverse effects * * *.[18]

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holding company to acquire an interest, including even a controlling interest, in a publicly held investment company, and Section 4(a)(2) authorizes the holding company to provide management services to all companies in which it has a controlling interest. The conjunction of these two powers allows a much more pervasive involvement in the affairs of the investment company than is contemplated by the regulation at issue in this case.

[18] The "proper incident" standard is to be applied by the Board on a case-by-case basis, in response to specific applications by individual bank holding companies. See *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 610-611 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551-552 & n.2 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 245-246 & n.19 (5th Cir. 1976), modified on other grounds, 558 F.2d 729 (1977), cert. denied,

Respondent's efforts to restrict bank holding companies to the activities permissible for banks not only has no statutory basis, it actually contradicts the Glass-Steagall Act. Respondent's arguments would obliterate the careful distinctions drawn by Congress in the Glass-Steagall Act, which impose different standards on banks and bank affiliates (including bank holding companies). See page 12, *supra*. If, in the Glass-Steagall Act itself, Congress chose not to prohibit bank holding companies from engaging in particular securities activities, then that Act plainly affords no basis for the imposition of such a prohibition through the medium of the Bank Holding Company Act. After all, as respondent repeatedly asserts (Br. 33-41), it has been a continuing theme of the legislative history of the Bank Holding Company Act that that Act neither contracts nor enlarges the prohibitions of the Glass-Steagall Act.

b. In light of the fact that bank holding companies may engage in a broader range of activities than banks, it is not necessary for this Court to consider respondent's argument that the activities authorized by the Board would be unlawful if undertaken by a bank. But the Court nevertheless should not be left with the erroneous impression that banks are restricted in the manner respondent suggests. If a bank otherwise were permitted to engage in such activities by its primary supervisory agency, Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, would not stand in the way (see note 4, *supra*).

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435 U.S. 904 (1978); *Independent Bankers Ass'n of Georgia* v. *Board of Governors*, 516 F.2d 1206, 1215-1216 & n.29 (D.C. Cir. 1975); *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1232-1234 & nn.2 & 4 (D.C. Cir. 1975); *BankAmerica Corp.* v. *Board of Governors*, 491 F.2d 985, 988 (9th Cir. 1974). As this Court recently noted in *Lewis* v. *BT Investment Managers, Inc.*, No. 79-45 (June 9, 1980), slip op. 19-20 n.13, the 1970 amendments to the Bank Holding Company Act were intended to give the Board even "greater discretion" than it previously exercised in discharging such responsibilities.

Section 16 provides that a bank may purchase certain types of securities only for the account of "customers," and not for its "own account." In managing a closed-end investment company within the limitations prescribed by the Board, a bank would not be purchasing and selling securities for its own account. Rather, the bank would engage in securities transactions for the account of and solely with funds provided by shareholders of the investment company. See S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933); H.R. Rep. No. 742, 74th Cong., 1st Sess. 18 (1935). Nor can it reasonably be contended that the investment company advisee, which is owned entirely by its shareholders, is not a "customer" for purposes of Section 16 simply because a bank initially organized it. Such a theory would prohibit a bank from managing the portfolios of common trust funds organized by the bank. See Pet. App. 62a-63a.[19]

Section 21 provides that banks may not engage "in the business of issuing, underwriting, selling, or distributing * * * securities." A bank serving as an investment adviser, and adhering to the limitations set forth in the Board's regulation and interpretive ruling, would not run afoul of that standard. The bank adviser itself would not issue securities, and since it would not be engaged at all in the underwriting of securities, *a fortiori* it would not be engaged in the "business" of underwriting. See Pet. App. 56a-57a; see also *SEC* v. *Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3, 31 (S.D.N.Y. 1968), aff'd, 435 F.2d 510 (2d Cir. 1970).[20]

8. Whereas in *Camp* this Court considered the possible hazards of the activities there at issue as additional reasons for enforcing the Glass-Steagall Act according to its

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[19] Respondent suggests (Br. 25) that Section 16 forbids a bank to receive a fee for serving as a fiduciary. However, the early interpretation of Section 16 relied on by respondent has been rescinded by the Comptroller of the Currency. See *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091, 1097-1101 (D.D.C. 1975), vacated on ripeness grounds, 562 F.2d 736 (D.C. Cir. 1977).

[20] See note 2, *supra*.

"literal terms" (401 U.S. at 639), respondent here offers a grab-bag of purported dangers as a justification for revising the statutes that Congress actually has written. See Br. 75-82. These "policy" arguments, however, provide no basis for deviating from the express terms of the statutes. *Aaron* v. *SEC*, No. 79-66 (June 2, 1980), slip op. 14-15.[21]

Respondent overlooks the fact that the hypothetical hazards it raises are protected against under the Board's regulation, state law, and the federal securities laws.[22] More fundamentally, the Board is empowered to remedy unsound banking practices that might arise in connection with a bank holding company's management of a closed-end investment company. See 12 U.S.C. 1818(b)(1), (3); see also 12 U.S.C. (Supp. II) 1844(e), 1847(b). And the Board is required by law to guard against "undue concentration of resources" and "unfair competition" in reviewing individual applications filed under Section 4(c)(8). See 12 U.S.C. 1843(c)(8). See also *Lewis* v. *BT Investment Managers, Inc.*, *supra*, slip op. 15 & n.10; Pet. App. 78a-79a.

Beyond this, respondent's arguments about potential hazards are entirely speculative. For example, respondent suggests no reason why a subsidiary bank would make a "rescue loan" to a company that issues securities held in an advisee's investment portfolio. Such a strategy would expose the banking organization to the risk of massive

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[21] Respondent's policy arguments prove too much. Nearly all of them could be raised with equal force with respect to a bank's operation of a trust department. See E. Herman, *Conflicts of Interest: Commercial Bank Trust Departments*, 123-127 (1975).

[22] For example, the Board's regulation prohibits a banking organization from recommending shares of its advisee investment company to persons having a fiduciary relationship with the organization. 12 C.F.R. 225.125(h). The Investment Company Act of 1940 prohibits the "dumping" of unsound assets into the portfolio of an investment company (15 U.S.C. 80a-17), and the SEC is vigilant in protecting against abuses by investment advisers. Misuse of confidential information, of course, is a violation of basic fiduciary principles enforceable under state law.

losses of its own funds, while producing a negligible effect on the advisory fee.[23] Similarly, respondent offers no reason why savings depositors would lose confidence in a bank based on the "poor performance" of the portfolio of an investment company advisee. The assets of the advisee are completely separate from those of depositors. Moreover, the performance of large common trust funds managed by banks is routinely published.[24] Publication of that information has not caused a "run" on any banking institution or otherwise adversely affected its soundness.[25]

In sum, respondent's policy arguments about "hazards" and "conflicts of interest" are entirely conjectural, are blunted by applicable legal safeguards, and in any event provide no basis for redrafting the statutes that Congress has enacted.

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[23] The typical annual fee for advising a closed-end investment company is approximately ½% of the assets of the fund. It is difficult to imagine a "rescue" loan, made in an attempt to avert the bankruptcy of an issuer of securities held in the portfolio of an investment company advisee, that would not involve a potential risk of loss to the lender many times greater than any diminution in the advisory fee. Moreover, even if a bank were subject to temptation to engage in imprudent lending of its own assets in the manner that respondent suggests, that temptation would arise with equal or greater force with respect to fiduciary accounts in the bank's own trust department. Periodic examination of the loan portfolios of banks by their supervisory agencies provide substantial protection against hypothetical abuses of this kind.

[24] Since 1975, information about the securities portfolios of large common trust funds has been disclosed pursuant to the Securities Exchange Act of 1934. See 15 U.S.C. 78m(f); 17 C.F.R. 240.13f-1. Detailed "performance" information is also made public by bank money managers. See *American Banker* 1, 10, 16 (Sept. 2, 1980) (survey of performance of equity funds of bank trustees).

[25] Depositors at most banks today are insured up to $100,000 by the Federal Deposit Insurance Corporation. See 12 U.S.C. 1813(m), as amended by Section 308(a)(1) of Pub. L. No. 96-221, 94 Stat. 147. This insurance was provided by Congress to maintain public confidence in banks that receive deposits.

For the foregoing reasons and the reasons set forth in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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Solicitor General

STEPHEN M. SHAPIRO
Assistant to the Solicitor General

OCTOBER 1980

APPENDIX

For the ten investment companies listed in respondent's brief (at 17-18), the public offerings of the companies' securities were handled by the following independent underwriting firms:

Name of Investment Company	Managing Underwriter(s) of Initial Public Offering
1) Bunker Hill Income Securities, Inc.	Lehman Brothers Incorporated Bache & Co. Incorporated DuPont Walston Incorporated Shearson, Hammill & Co. Incorporated Crowell, Weedon & Co. Sutro & Co. Incorporated
2) Circle Income Shares, Inc.	Goldman, Sachs & Co. Hayden Stone Inc. Thompson & McKinnon Auchincloss Inc. Robert W. Baird & Co. Incorporated
3) Current Income Shares, Inc.	Lehman Brothers Incorporated duPont Glore Forgan Incorporated Walston & Co., Inc. Crowell, Weedon & Co. Rauscher Pierce Securities Corporation Stern, Frank, Meyer & Fox Incorporated Sutro & Co. Incorporated
4) Excelsior Income Shares, Inc.	Kidder, Peabody & Co. Incorporated Bache & Co. Incorporated Clark, Dodge & Co. Incorporated Harris, Upham & Co., Incorporated Walston & Co., Inc.
5) Fort Dearborn Income Securities, Inc.	Salomon Brothers duPont Glore Forgan Incorporated A.G. Becker & Co. Incorporated

Name of Investment Company	Managing Underwriter(s) of Initial Public Offering
6) Hatteras Income Securities, Inc.	Salomon Brothers Hornblower & Weeks-Hemphill Noyes Incorporated J.C. Bradford & Co. Incorporated A.G. Edwards & Sons, Inc. Interstate Securities Corporation The Robinson-Humphrey Company, Inc. Wheat, First Securities, Inc.
7) Independence Square Income Securities, Inc.	Eastman Dillon, Union Securities & Co. Incorporated Loeb, Rhoades & Co.
8) Montgomery Street Income Securities, Inc.	Blyth Eastman Dillon & Co. Incorporated duPont Glore Forgan Incorporated Salomon Brothers Dean Witter & Co. Incorporated
9) Pacific American Income Shares, Inc.	Morgan Stanley & Co. Incorporated E.F. Hutton & Company Inc. Bateman Eichler, Hill Richards Incorporated
10) Vestaur Securities, Inc.	Bache & Co. Incorporated

See R. 544-556, 691-706, 788-800, 864-878, 988-1001, 1063-1074, 1148-1163, 1478-1494, 1801-1810, 2136-2146.

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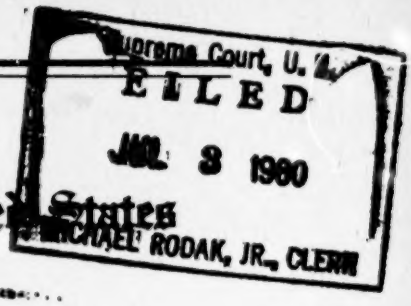

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF A. G. BECKER INCORPORATED, *AMICUS CURIAE*

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BRIEF OF A. G. BECKER INCORPORATED, *AMICUS CURIAE*

THE INTEREST OF A. G. BECKER INCORPORATED

In 1933, responding to the well-documented securities market abuses and excesses of commercial banks, and again in 1956, 1966 and 1970, Congress unambiguously prohibited commercial banks directly or indirectly from entering into, or engaging in, the securities business.

Despite the ac ption of such statutory limitations, however, commercial banks repeatedly have attempted to obtain, and federal banking regulators all too frequently have attempted to grant, administrative approbation for bank efforts to circumvent applicable banking law strictures.[1]

The instant case is, unfortunately, a prime example of this ongoing effort to rewrite an important Congressional mandate by the use of administrative fiat; here, the Board of Governors of the Federal Reserve System (the "Board") has exalted form over substance by authorizing commercial banks to form nonbank affiliates in order to engage *indirectly* in conduct commercial banks are outlawed from pursuing *directly*.

As a registered broker and dealer in securities, A. G. Becker Incorporated ("A. G. Becker") is directly and adversely affected by such Board efforts to reshape the

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[1] *See, e.g., Investment Company Institute* v. *Camp*, 401 U.S. 617, 639 (1971) (holding invalid a regulation of the Comptroller of the Currency (the "Comptroller") authorizing national banks to operate mutual funds); *Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 550 (C.A. 7, 1978) (bank holding companies may not operate travel agencies); *Nat'l Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1241 (C.A. D.C., 1975) (holding invalid that part of the Board's ruling permitting bank affiliates to provide nonfinacially related courier services); *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427, 438 (C.A. 1, 1972) (holding invalid the Comptroller's regulation permitting national banks to operate travel agencies); *Saxon* v. *Georgia Ass'n of Independent Ins. Agents, Inc.*, 399 F.2d 1010, 1016 (C.A. 5, 1968) (holding invalid the Comptroller's ruling permitting national banks to act as insurance agents in places of over 5,000 population); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247, 252 (D. D.C., 1966) *affirmed sub nom., Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497, 504 (C.A. D.C., 1968) (holding invalid the Comptroller's ruling permitting national banks to underwrite municipal revenue bonds).

language and meaning of the Banking Act of 1933[2] and related banking legislation. A. G. Becker, in addition to providing a broad spectrum of traditional investment banking services, is one of this Country's largest commercial paper underwriters and dealers, assisting major corporate issuers in raising short-term capital by selling their commercial paper securities to various institutional investors. Although the underwriting of commercial paper securities traditionally has been performed by investment bankers (*but never previously by commercial banks*), at least one commercial bank subject to the Board's jurisdiction has, for the first time, commenced underwriting commercial paper in contravention of the prohibitions of the Glass-Steagall Act.

Consistent with its general approach toward the enforcement of the Glass-Steagall Act, the Board has taken no action for almost two years on two petitions seeking Board action to halt this underwriting of securities by commercial banks;[3] indeed, notwithstanding the plain language of the Glass-Steagall Act, and despite the fact that commercial banks had, theretofore, never underwritten commercial paper, the Board's chief legal officer has publicly opined that the underwriting of commercial

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[2] Often referred to as the Glass-Steagall Act, the Banking Act of 1933 is codified at various sections throughout Title 12 of the United States Code. In terms, the prohibitions of the Glass-Steagall Act apply to national banks but, insofar as is relevant here, they also are expressly made applicable to state member banks of the Federal Reserve System. *See* 12 U.S.C. §335 (1976).

[3] A. G. Becker's petition to the Board is predicated, among other things, on Board procedures set forth in 12 CFR §§227.1, 227.2, and 262.3 (1980). Under these complaint procedures, the conduct cited need not be illegal to warrant proscription by the Board as an "unfair" or "deceptive" banking practice. 41 *Fed. Reg.* 44361 (Oct. 8, 1976).

paper securities is "incidental to the business of banking," and should not be inhibited.[4]

In this regard, the Board staff's opinion regarding the underwriting of commercial paper securities by banks is merely the latest in a series of conflicting and confusing administrative pronouncements from the Board—pronouncements that often conflict with each other as to the appropriate application of governing legal principles, but which are remarkably consistent in expanding the number of services commercial banks are authorized to perform.[5]

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[4] Legal Division of the Board of Governors of the Federal Reserve System, *Commercial Paper Activities of Commercial Banks: a Legal Analysis*, pp. 4-6 (Jun. 28, 1979) [hereafter cited as "Legal Analysis"].

[5] Thus, for example, in 1977 the staff of the Board issued a study encouraging commercial banks to engage in the private placement of unregistered investment securities. *See* Federal Reserve Board Staff, *Commercial Bank Private Placement Activities* (1977). In that study, the Board had to determine, *inter alia*, whether commercial bank private placement activities constituted the "underwriting" of securities, since the "underwriting" of securities by a bank is an activity unquestionably proscribed by the Glass-Steagall Act. *Id.* at 87. In holding that banks *could* engage in such private placement activities without violating the Glass-Steagall Act, the Board concluded that the private placement of securities is not "underwriting" within the meaning of the Glass-Steagall Act, because bona fide private placements do not constitute "underwriting" within the meaning of the federal securities laws adopted at the same time as the Glass-Steagall Act. In reaching its decision, the Board noted that, where securities-related terms are defined in the federal securities laws, but the same terms are not defined in the Glass-Steagall Act, "Congress' use of the same terms in the two measures suggests that the Securities Act [of 1933] is a compelling analogy." *Id.* at 89.

Two years later, however, the Board's staff authorized banks to underwrite the distribution of commercial paper based, in part, upon the conclusion that commercial paper is not a "security" for purposes of the Glass-Steagall Act (which does not define the term "security"), even though commercial paper is within the definition of the term "security" as set forth in Sections 2(1) and 3(a)(3) of the Securities Act, 15 U.S.C. §§77b(1) and 77c(a)(3) (1976). Legal Analysis at 15 n. 34.

This case, therefore, presents a question of significance and importance to A. G. Becker—that is, whether the Glass-Steagall Act, and the interrelated proscriptions of the Bank Holding Company Act, may properly be interpreted by the federal banking agencies so as to endorse and encourage commercial banking activities Congress sought to prohibit. Less than a decade ago, this Court noted that the terms of the Glass-Steagall Act could not be ignored or eviscerated by those government agencies charged with the administration of that statute. *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). A. G. Becker respectfully submits this brief, *amicus curiae*, in support of respondent, to express its view that this Court's prior teachings, and Congress' unmistakeable admonitions, should be applied to prevent the Board from eroding the protections and proscriptions of the federal banking laws.[6]

QUESTION ADDRESSED

Did the Board of Governors of the Federal Reserve System exceed the Board's limited statutory authority when it promulgated rules permitting commercial banks, either directly or through specially-created nonbank affiliates, to engage in conduct expressly prohibited by the Banking Act of 1933?

STATEMENT[7]

1. *The Challenged Regulation and Interpretive Ruling.* Effective February 1, 1972, the Board issued a

[6] The parties have consented to the filing of this brief. Copies of letters indicating the parties' consent are attached hereto as Appendix A.

[7] Since a full statement of the facts has been set forth in the brief of the respondent, we have not restated the facts here, but rather have set forth only those facts salient to the discussion that follows.

regulation authorizing any bank holding company and both its bank and nonbank subsidiaries to serve as an investment adviser to any and all investment companies, including open-end investment companies.[8] Because the scope of an investment adviser's services under the Board's rule could include the authority to organize, control, operate or manage any investment company,[9] the Justice Department and the Investment Company Institute ("ICI") opposed the Board's determination on the ground that such activities, if engaged in by banks or their affiliates, would violate the Glass-Steagall Act (Pet. App. 6a-7a).[10] Recognizing that "the Glass-Steagall Act provisions . . . [are] applicable to a holding company's activities as an investment adviser," but unwilling to rescind its regulation, the Board attempted to resolve the Glass-

[8] 12 CFR §225.4(a)(5)(ii) (1980). An investment company utilizes a pool of funds contributed by its shareholders for the sole purpose of investing in "the securities of other corporations, and issues securities of its own." *United States* v. *Nat'l Ass'n of Securities Dealers, Inc.*, 422 U.S. 694, 697 (1975) (footnote omitted). This pool of funds is obtained through the public distribution (and, oftentimes, periodic sales) of the company's securities to the investing public. Each share of an investment company represents a fractional interest in the company's portfolio of securities. *Id.* at 698. By virtue of the Investment Company Act of 1940, investment companies are either open-end companies or closed-end companies. As defined in that Act, the sole difference between the two types of investment companies is that an open-end company (often called a "mutual fund") stands ready to issue and redeem its shares on a continuous basis, 15 U.S.C. §80a-5(a)(1) (1976), while a closed-end company's shares are traded in the open market. 1 Frankel, *The Regulation of Money Managers* 341 (1978).

[9] The Board's determination authorized bank holding companies to perform any and all functions performed by an investment adviser, including those functions within the purview of Section 2(a)(20) of the Investment Company Act, 15 U.S.C. §80a-2(a)(20) (1976).

[10] References to the Appendix filed in this Court with the Petition for a Writ of Certiorari are cited as "Pet. App. ."

Steagall Act problems engendered by its expansive rules through the device of an interpretive ruling.[11]

In terms, the Board's rules permit bank holding companies *and* their *bank* as well as nonbank subsidiaries to serve as investment advisers to *any* investment company.[12] In its interpretive ruling, the Board purported to retract so much of its rules as permitted any of the entities subject to its jurisdiction to serve as advisers to *open-end* investment companies;[13] subsequently, the Board also "disclaim[ed]" that its rule was meant to apply to banks.[14] These patching efforts, however, have proven ineffectual—banks apparently continue to sponsor investment companies in reliance upon the language of the Board's rules,[15] and several of the investment companies so advised are conceded by the Board "technically" to be open-end funds.[16]

2. *The Investment Company Institute's Challenge to the Board's Regulation and Interpretive Ruling.* In response to the ICI's petition for judicial review of the

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[11] 12 CFR §225.125(b) (1980), *adopted in* 37 *Fed. Reg.* 1464 (Jan. 29, 1972).

[12] 12 CFR §225.4(a)(5)(ii) (1980). The term "bank holding company" is defined for purposes of the Board's rule to include both types of subsidiaries. 12 CFR §225.125(c) (1980).

[13] 12 CFR §225.125(f) (1980).

[14] *See* Pet. App. 22a.

[15] As the ICI points out in its brief, five of the ten entities currently sponsoring closed-end investment companies are banks, not holding companies or nonbank affiliates (Br. at 17-18, *citing* Weisenberger, *Investment Companies Service*).

[16] Pet. App. 59a. Since even the Board apparently concedes that its rule is *per se* invalid to the extent it authorizes *banks* to serve as investment advisers to *any* investment company, and to the extent it authorizes nonbank affiliates to advise *open-end* investment companies, in this brief we discuss only that aspect of the Board's rule that authorizes a bank holding company to serve as an investment adviser to a closed-end fund.

Board's action,[17] a unanimous Court of Appeals for the District of Columbia Circuit vacated the challenged regulation and interpretive ruling (Pet. App. 50a). The court of appeals noted that the Glass-Steagall Act and the Bank Holding Company Act were designed to achieve a single goal—the divorce of commercial banking from the securities business—a goal accomplished by the Glass-Steagall Act's proscriptions on the activities of commercial banks, and the Bank Holding Company Act's complementary restrictions on the activities of nonbank affiliates of commercial banks (*id.* at 28a-29a).

Noting that Congress did not perceive "that the securities activities of bank holding companies or their nonbank affiliates were any less insidious than those of banks themselves or of firms with which banks were affiliated directly rather than through a holding company parent" (*id.* at 26a), the court examined the language and legislative history of the Bank Holding Company Act and found that that Act was "designed to further the Glass-Steagall Act's overarching policy . . . of divorcing investment from commercial banking" (*id.* at 30a, footnote omitted).

In sum, the court's examination of both the Glass-Steagall Act and the Bank Holding Company Act led it inexorably to conclude that, since the Glass-Steagall Act was first enacted, Congress has continuously maintained a forceful policy of preventing the evils and abuses that arise from the involvement of commercial banks in the securities business (*id.* at 32a, 44a). The court concluded that, had Congress intended to eviscerate the protections of the Glass-Steagall Act by permitting banks to funnel their

[17] The history of the Investment Company Institute's challenges to the Board's regulation and ruling is set forth in the ICI's brief herein, at pp. 6-10.

securities activities through nonbank affiliates, Congress surely would have stated so expressly in the Bank Holding Company Act. The Board's petition for a writ of *certiorari* ensued.

INTRODUCTION AND SUMMARY

National and state member banks, which may engage only in those activities authorized by law, are forbidden by the Glass-Steagall Act from engaging in the securities business, a business Congress has expressly declared includes the sponsorship, operation and management of investment companies. *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629-630, 635-636 (1971). And, this prohibition against banks performing investment advisory services applies whether banks propose to do so for open-end or closed-end investment companies, since the business of both types of companies is defined identically in the Investment Company Act of 1940 to constitute investing, reinvesting and trading in securities—in other words, the securities business.

Despite its recognition of these unmistakeable implications of the Glass-Steagall Act, 12 CFR § 225.125(b) (1980), the Board has effectively ruled that banks may do indirectly what they are prohibited from doing directly; the Board has authorized national and state member banks to utilize the 1930's-discredited device of securities affiliates in order to circumvent the Glass-Steagall Act's injunction that banks may not organize, sponsor, or manage closed-end investment companies. But, the plain meaning of Sections 16, 20, 21 and 32 of the Glass-Steagall Act leaves no room for doubt that Congress "separate[d] *as far as possible* national and [Federal Reserve System] member banks from [securities] affiliates of *all* kinds," S. Rep. No. 77, 73d Cong., 1st Sess. 10

(1933) (emphasis supplied), a conclusion this Court reached and endorsed less than a decade ago. *Investment Company Institute* v. *Camp, supra*, 401 U.S. at 629, 635. There is thus no basis for the Board's argument that, by negative implication, Congress intended to permit by indirection what this Court held Congress has so painstakingly "abolish[ed]." *Id.* at 629.

Nor can the Board sustain its action by reference to the Bank Holding Company Act. That Act was designed to reinforce and supplement the Glass-Steagall Act, not to provide a vehicle for its evisceration. Conduct otherwise illegal cannot, and does not, constitute either banking, an activity closely related to banking, or a proper incident of banking, particularly where, as here, the Board itself concedes (Br. 31-32) that the precise "conflicts of interest and unsound banking practices" that prompted Congress to adopt both the Glass-Steagall Act and the supplementary Bank Holding Company Act could be engendered by the practices the Board's ruling seeks to encourage and foster.

DISCUSSION

THE GLASS-STEAGALL ACT, WHICH SEPARATES COMMERCIAL BANKING FROM THE SECURITIES BUSINESS, PROHIBITS A BANK FROM DIRECTLY OR INDIRECTLY SERVING AS AN INVESTMENT ADVISER TO ANY INVESTMENT COMPANY.

When Congress enacted the Glass-Steagall Act, it "separate[d] *as far as possible* national and [Federal Reserve System] member banks from [securities] affil-

iates of *all* kinds."[18] Thus, as expressly embodied in several of the provisions of the statute, Congress decreed that investment banking and commercial banking should be carried out separately by different, *and unrelated*, institutions. Since 1933, Congress has not adopted any statute which, in terms or otherwise, modifies, alters or abrogates this separation between commercial and investment banking, a conclusion effectively conceded by the petitioner.[19]

The unquestioned effect of the Board's rules and interpretive ruling, however, is to permit banks, through specially-created nonbank affiliates, to enter the securities business, despite the fact that such a fundamental change in national policy must be addressed to, and effected by, the Congress, not the Board. *See, e.g., Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578-579 (1979); *Securities and Exchange Commission* v. *Sloan*, 436 U.S. 103, 116-117 (1978). As it has had to do on prior occasions, this Court should reaffirm the continuing vitality of the Glass-Steagall Act, and enforce its restriction of commercial banks to the business of banking.[20]

A. The Plain Language of the Glass-Steagall Act Prohibits Banks from Organizing, Sponsoring, or Managing Any Investment Company

In construing the Glass-Steagall Act, as with any statute, it is well-settled that the starting point is the

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[18] S. Rep. No. 77, 73d Cong., 1st Sess. 10 (1933) (emphasis supplied). *See also*, 77 Cong. Rec. 3835 (1933) (Remarks of Rep. Steagall); *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629, 635.

[19] *See* p. 7 and n. 16, *supra*.

[20] *See Board of Governors* v. *Agnew*, 329 U.S. 441 (1947); *Investment Company Institute* v. *Camp*, *supra*.

statutory language itself.[21] Here, the plain language of the Glass-Steagall Act evidences Congress' intent to preclude banks from organizing, sponsoring, or managing any investment company.

The Glass-Steagall Act contains two interrelated provisions that operate to preclude banks from engaging in the securities business: Section 16, among other things, prohibits banks from underwriting or dealing for their own accounts in securities and stocks, subject to very circumscribed limitations not applicable here;[22] and, Sec-

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[21] *See, e.g., Aaron* v. *Securities and Exchange Commission*, 48 U.S.L.W. 4609, 4613 (U.S., Jun. 2, 1980); *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 48 U.S.L.W. 4658, 4659 (U.S., Jun. 9, 1980); *Chiarella* v. *United States*, 100 S. Ct. 1108, 1113 (1980); *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 16 (1979); *Touche Ross & Co.* v. *Redington, supra*, 442 U.S. at 568; *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 558 (1979); *Securities and Exchange Commission* v. *Sloan, supra*, 436 U.S. at 111; *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197, *rehearing denied*, 425 U.S. 986 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756, *rehearing denied*, 423 U.S. 884 (1975) (Powell, J., concurring).

[22] 12 U.S.C. §24 Seventh (1976). Thus, for example, Section 16 provides that a bank "shall not underwrite *any* issue of securities or stock. . . . " *Id.* (emphasis supplied). Exceptions are provided which permit a bank to underwrite certain types of governmental securities, such as obligations of the United States and of state and local governments. This exception has been construed narrowly to limit banks to the underwriting of general obligation instruments only. *See, e.g., Baker, Watts & Co.* v. *Saxon, supra*, 261 F. Supp. at 252. And, Section 16 limits a bank "to purchasing and selling . . . securities and stock without recourse, solely upon the order, and for the account of, customers. . . . " This provision has been construed to permit banks to purchase and sell securities only at the request of *existing* customers, as an accommodation service, and not for profit. *New York Stock Exchange, Inc.* v. *Smith*, 404 F.Supp. 1091, 1097 (D. D.C., 1975), *vacated and remanded on other grounds, sub nom., New York Stock Exchange, Inc.* v. *Bloom*, 562 F.2d 736 (C.A. D.C., 1977), *certiorari denied sub nom., New York Stock Exchange, Inc.* v. *Heimann*, 435 U.S. 942 (1978), *citing*, Bulletin, Comptroller of the Currency, No. 2 (Oct. 26, 1935). *See also*, S. Rep. No. 77, 73d Cong., 1st Sess. 16 (1933).

tion 21 reinforces these proscriptions with an unqualified prohibition, making it unlawful for any person or firm that underwrites, sells or distributes securities to "engage at the same time *to any extent whatever* in the business" of deposit banking.[23]

In *Investment Company Institute* v. *Camp, supra*, 401 U.S. at 625, this Court confirmed that, "[*on*] *their face*, §§16 and 21 of the Glass-Steagall Act appear clearly to prohibit . . ." a bank from sponsoring an investment company because, among other reasons, an investment company (whether or not it is an open-end company, as in the *Camp* case) engages in "buying stock 'for its own account' and . . . 'issuing' and 'selling' 'stock' or 'other securities' evidencing . . . the assets of the fund." *Id.* (footnote omitted). Sections 16 and 21 of the Glass-Steagall Act thus demonstrate, as this Court has held, that "Congress explicitly intended to prohibit a national [or state member] bank from operating an investment trust." *Id.* at 635 (footnote omitted).

B. Commercial Banks are Prohibited Indirectly From Organizing, Sponsoring, or Managing Any Investment Company through Nonbank Affiliates

1. *Banks are Confined to the Business of Banking, and the Securities Business is Expressly Closed to Bank Participation.*

It is axiomatic that the federal banking laws define the business of commercial banking for national and state

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[23] 12 U.S.C. §378 (1976) (emphasis supplied). The purpose of Section 21 of the Glass-Steagall Act was "to make sure that we will accomplish the separation of the investment and deposit banking." 77 Cong. Rec. 4180 (1933) (remarks of Sen. Bulkley). Section 21 does not prohibit banks "from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, *to the extent* permitted to national banking associations by the provisions of [Section 16]" (emphasis supplied).

member banks,[24] and that the "privileges granted to [such banks] by law" are specifically enumerated by statute.[25] All commercial and industrial activities not expressly permitted to such banks by Congress are necessarily excluded from banking participation.[26] Thus, had Congress spoken no more on the subject, banks would have been excluded from the securities business.[27] Congress has, however, done more than merely fail to authorize bank participation in the securities business; it has affirmatively forbidden such activities.

In the face of these Congressional declarations, the Board has nevertheless attempted to authorize banks to gain a foothold in the securities business by providing investment advisory services to some investment companies, on the basis of a purported distinction between open-end and closed-end investment companies. This distinction, based on the frequency with which the two types of funds issue or redeem their shares, has little basis in fact, and none in law or policy. While it is true that open-end companies can be distinguished from closed-end companies by the manner in which an investor normally

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[24] *See, e.g., Franklin Nat'l Bank* v. *New York*, 347 U.S. 373, 375-376 (1953).

[25] 12 U.S.C. §24 Sixth and Seventh (1976); 12 U.S.C. §341 Sixth (1976).

[26] *See, e.g.*, 77 Cong. Rec. 3835 (1933) (Remarks of Rep. Steagall); *Arnold Tours, Inc.* v. *Camp, supra*, 472 F.2d at 435-436; *Saxon* v. *Georgia Ass'n of Independent Ins. Agents, Inc., supra*, 399 F.2d at 1014; *Baker, Watts & Co.* v. *Saxon, supra*, 261 F. Supp. at 252. *Cf. Transamerica Mortgage Advisors, Inc.* v. *Lewis, supra*, 444 U.S. at 20; *Botany Worsted Mills* v. *United States*, 278 U.S. 282, 288 (1929).

[27] Indeed, as this Court pointed out in *Investment Company Institute* v. *Camp, supra*, 401 U.S. at 629, "[e]ven before the passage of the [Glass-Steagall] Act it was generally believed that it was improper for a commercial bank to engage in investment banking directly."

disposes of his interest in these companies,[28] that is simply not a relevant consideration here. Congress has expressly declared by statute that open-end *and* closed-end companies engage in the *same* general *securities* business activities,[29] and that the management of *any* investment company is an integral part of the securities business.[30]

Not only is the Board's purported distinction between closed-end and open-end funds negated in all material respects by statute, the distinction the Board attempted to draw—focusing on the differences in the way shareholders of the two types of companies may dispose of their shares—is unavailing and unsupportable. Closed-end companies may, and do, issue new shares at any time, just as is true of open-end companies; closed-end funds also

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[28] *See* p. 6 n. 8, *supra*.

[29] Thus, subsections (1) and (3) of Section 3(a) of the Investment Company Act, 15 U.S.C. §§80a-3(a)(1) and 80a-3(a)(3) (1976), define *both* open and closed-end investment companies as those companies engaged "in the *business* of investing, reinvesting, or trading in *securities*" (emphasis supplied).

[30] Section 2(a)(20) of the Investment Company Act, 15 U.S.C. §80a-2(a)(20) (1976), (to which the Board looked in defining the term "investment adviser"), Sections 1 and 2(a)(11) of the Investment Advisers Act, 15 U.S.C. §§80b-1 and 80b-2(a)(11) (1976), and this Court's opinion in *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963), make plain the fact that providing investment advisory services to *any* investment company is an important facet of the "*securities industry.*" *See also, United States* v. *Nat'l Ass'n of Securities Dealers, Inc., supra*, 422 U.S. at 697-698; *Burks* v. *Lasker*, 441 U.S. 471, 480-481 (1979); *E. I. duPont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 54-55 (1977).

may, and often do, offer to repurchase their shares, facts Congress specifically recognized.[31]

In short, the business of *any* investment company is dealing in securities, and the occupation of an adviser to *any* investment company is managing that business. The management of any investment company by a bank necessarily involves the bank in securities activities that are forbidden to banks by the Glass-Steagall Act.

2. *The Prohibitions of the Glass-Steagall Act May Not Be Circumvented by Indirection.*

By the language it employed in the Glass-Steagall Act, Congress left no doubt that the separation it had effected between commercial and investment banking applies broadly to both direct *and indirect* bank securities activities.

Thus, as we have seen, Section 16 of the Act prohibits banks from engaging in "the securities business" except to purchase and sell securities "*solely*" upon the order, and for the account of, customers and "*in no case*" for the bank's own account. By virtue of Section 16, banks are also forbidden to underwrite "*any*" issue of securities. 12 U.S.C. §24, Seventh (1976) (emphasis supplied). Section 21 of the Act prohibits "*any* person" or firm engaged in the securities business from engaging, at the same time,

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[31] *See* Sections 23(b) and 23(c) of the Investment Company Act, 15 U.S.C. §§80a-23(b) and 80a-23(c) (1976), which govern the distribution and *repurchase* of securities by closed-end companies. *And see, e.g.*, H.R. Rep. No. 2639, 76th Cong., 3d Sess. 8, 21 (1940); 86 Cong. Rec. 9811 (1940) (Remarks of Rep. Cole); House Committee on Interstate and Foreign Commerce, *Hearings on H.R. 10065, Investment Trusts and Investment Companies*, 76th Cong., 3d Sess. 124-125 (1940) (Statement of Mr. Schenker); Senate Committee on Banking and Currency, *Hearings on S. 3580*, 76th Cong., 3d Sess. 294 (1940) (Statement of Mr. Smith).

"*to any extent whatever*," in the business of commercial banking. 12 U.S.C. §378(a)(1) (1976) (emphasis supplied).

Moreover, Congress attempted to preclude banks from casually evading the Glass-Steagall Act by establishing stringent penalties against the use of affiliates by banks to engage in activities forbidden to banks themselves. Section 20 of the Act authorizes the imposition of fines against, and the divestiture of the rights of, commercial banks that affiliate "in *any* manner" with companies principally engaged in the distribution or "*public sale*" of securities;[32] the term "affiliate," in turn, is broadly defined in Section 2(b) of the Glass-Steagall Act to include *any* direct or indirect control relationship or common ownership between a bank and a securities firm.[33]

To avoid the improper conflicts of interest that Congress found inevitably arise from the combination of commercial banking and the securities business, Section 32 of the Glass-Steagall Act, 12 U.S.C. §78 (1976), also prohibits *any* "[i]nterlocking managements between national or state member banks and securities firms."[34] Finally, Section 19 of the Act, prior to its repeal in 1966, precluded a bank holding company from voting its stock in a bank if it had "*any* [ownership] interest in," or was "participating" in the management of, a "securities company."[35] As this Court has noted in the context of a

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[32] 12 U.S.C. §377 (1976) (emphasis supplied).

[33] As defined, the term affiliate includes "*any* corporation . . . [or] similar organization" which is a holding company of a member bank, 12 U.S.C. §221a(b)(4) (1976) (emphasis supplied), or which is a subsidiary of a company which owns a member bank, 12 U.S.C. §221a(b)(2) (1976).

[34] Pet. App. 18a-19a.

[35] 48 Stat. 186 (repealed 1966).

companion regulatory scheme, each of "[t]hese proscriptions . . . are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive."[36]

In addition to the plain meaning of these statutory provisions, each must be interpreted bearing in mind Congress' overall *purpose* in enacting the Glass-Steagall Act—to separate commercial banking from the securities business. *See Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629-630. As this Court there pointed out:

> "[I]n 1908 banks began the practice of establishing security affiliates that engaged in, *inter alia*, the business of floating bond issues . . . . The Glass-Steagall Act confirmed that national banks could not engage in investment banking directly, and in addition made affiliation with an organization so engaged illegal. *One effect of the Act was to abolish the security affiliates of commercial banks.*"[37]

It is apparent from the legislative history of the Act why Congress felt that the "drastic step" of abolishing

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[36] *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151, *rehearing denied*, 408 U.S. 931 (1972). *See also*, *United States* v. *Naftalin*, 441 U.S. 768, 773 (1979).

[37] 401 U.S. at 629 (emphasis supplied; footnote omitted). One of the types of securities affiliates abolished by the Act was affiliated investment companies. In its 1939 study of investment companies, the Securities and Exchange Commission reported to Congress that the Glass-Steagall Act had achieved its objective of precluding bank sponsorship of *closed-end* investment companies, which were the only type of investment company sponsored by commercial banks or their securities affiliates. This abolition was cited by the Commission as one of the "most striking changes in the sponsorship of *closed-end* companies" between 1929 and 1935. Securities and Exchange Commission, *Report on Investment Trusts and Investment Companies*, Pt. 2, H.R. Doc. No. 70, 76th Cong., 1st Sess. 59, 124 (Table 25) (1939) (emphasis supplied).

bank securities affiliates was necessary (401 U.S. at 629). Not only had there been bank failures attributable to the activities of bank securities affiliates, but Congress "was [also] concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline[s] partly because of their direct *and indirect* involvement in the trading and ownership of speculative securities."[38] As noted during the Congressional debates on the Glass-Steagall Act, "[t]he numerous sections of [the Act] are interrelated with a single purpose . . . to sweep away *the whole machinery* of the investment business of member banks . . . ."[39]

In the face of the language of the various provisions of the Glass-Steagall Act described above, the statute's legislative history, and this Court's unambiguous construction of the Act in *Camp*—all evidencing an intent by Congress to prohibit banks from *any* affiliation with entities engaged in the securities business—the Board argues (Br. 19-30) that Section 20 of the Glass-Steagall Act somehow "permits" banks to sponsor closed-end funds through securities affiliates. The board's argument is unavailing.

To begin with, Section 20 contains no *affirmative* grant of authority or permission for banks to do anything, much less for banks to establish affiliates that will serve as advisers to closed-end investment companies. But, Sections 16, 20, 21, and 32, and former Section 19, of the

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[38] *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630 (emphasis supplied; footnote omitted); S. Rep. No. 77, 73d Cong., 1st Sess. 10 (1933).

[39] 76 Cong. Rec. 1412 (1933) (Remarks of Sen. Metcalf) (emphasis supplied). *Accord*, *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625-626 n. 12.

Glass-Steagall Act, taken together, as we have seen, *prohibit* banks directly or indirectly from sponsoring or serving as investment advisers to such investment companies. Moreover, the Board's construction of Section 20 conveniently, and understandably, ignores the plain meaning of the statute; Section 20 established severe civil penalties for bank affiliations with companies principally engaged in certain facets of the securities business, including those engaged in the "public sale" of "stocks, bonds, debentures, notes, or other securities . . . ." By statute, Congress defined both closed-end and open-end investment companies as being engaged in the business of publicly selling and buying securities.[40]

In any event, this Court has already rejected the equivalent of the Board's current interpretation of the meaning of Section 20, in *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 625-626 n. 12; there, the Court endorsed the Board's former interpretation (apparently now abandoned to comport with the Board's current litigation strategies) that a separately-structured investment company and its affiliated bank sponsor must be treated as a "single entity" for *all* purposes under the Glass-Steagall Act.[41] As this Court concluded, "there is no danger that to characterize the bank and its fund as a single entity will disserve the purpose of Congress." *Id.* Unfortunately, as this case illustrates, there is every danger that the Board's shifted posture would, indeed, "disserve" and distort "the purpose of Congress."

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[40] In *Camp*, this Court noted that the term "public sale," used in both Sections 20 and 32 of the Glass-Steagall Act, encompasses the same activities included within the purview of the proscription, in Section 21 of the Act, against the "selling" of securities by banks. 401 U.S. at 625-626 n. 12.

[41] 401 U.S. at 625-626 n. 12, *citing* 12 CFR §218.111 (1970).

3. *The Bank Holding Company Act Reinforces the Prohibitions of the Glass-Steagall Act.*

As we have seen, the Glass-Steagall Act prohibits national and state member *banks* from directly or indirectly creating, operating, controlling or managing any investment company, and from being affiliated in any way with any entity that does. In this case, of course, the Board has authorized *bank holding company* affiliates of banks to serve as a vehicle for circumventing these proscriptions against the union of investment and commercial banking. The Board's rule and regulation are valid, therefore, only if the Bank Holding Company Act—pursuant to which the Board purported to act—authorizes the Board to override the express strictures of the Glass-Steagall Act. As we discuss below, however, the Bank Holding Company Act contains no such authorization.

At the outset, it is significant to bear in mind that a principal purpose underlying the addition of the Bank Holding Company Act in 1956 was to supplement and strengthen the Glass-Steagall Act, not to circumvent it.[42] Through the amendments to the Bank Holding Company Act in 1966 and 1970, Congress' essential purpose remained unchanged, as the Board concedes.[43]

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[42] S. Rep. No. 1095, 84th Cong., 2d Sess. 2, *reprinted in* [1956] U.S. Code Cong. & Ad. News 2482, 2483.

[43] *See* 12 CFR §225.125(b) (1980). *And see, e.g.*, S. Rep. No. 1179, 89th Cong., 2d Sess. 2, *reprinted in* [1966] U.S. Code Cong. & Ad. News 2385, 2386 (a purpose of the Bank Holding Company Act is to apply to bank holding companies "the general purposes of the Glass-Steagall Act of 1933"); S. Rep. No. 1084, 91st Cong., 2d Sess. 24, *reprinted in* [1970] U.S. Cong. & Ad. News 5519, 5541 (definition of "bank" in Bank Holding Company Act designed to exclude institutions not engaged in commercial banking); House Committee on Banking and Currency, *Hearings on H.R. 6778*, 91st Cong., 1st Sess. 205 (1969) (J. Robertson, Board Vice-Chairman) ("When Congress has clearly limited the powers of banks, they should not be permitted to circumvent such limitations either through subsidiary corporations or through affiliation in a holding company system.").

Thus, consistent with the Glass-Steagall Act, Section 4(a) of the Bank Holding Company Act, 12 U.S.C. §1843(a) (1976), broadly prohibits bank holding companies from (i) owning the shares of *any* company that is neither a bank nor a bank holding company, and (ii) engaging in *any* activities other than banking or managing a bank. Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. §1843(c)(8) (1976), the principal reed upon which the Board's contested rule-making was predicated, effects a limited exception from these prohibitions for a bank holding company's ownership of the shares of a company the activities of which are "*so closely related* to banking . . . as to be a *proper* incident thereto." (Emphasis supplied).

On its face, Section 4(c)(8) contains no authority empowering the Board to override the Glass-Steagall Act, or to encourage bank holding companies to engage in the securities business. This is not surprising, since Congress can hardly have been expected to eviscerate the effects of legislation it was attempting to strengthen.[44] Moreover, the significance of this omission is confirmed by the plain language of Section 4(c)(8), which indicates that two distinct tests must be satisfied before the Board may exercise the limited authority it has been given to sanction bank holding company activities other than banking or managing a bank—the activity must be "closely related" to banking, and it must be a "proper incident" to banking.[45]

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[44] *See*, S. Rep. No. 1179, *supra*, at 2; House Committee on Banking and Currency, *Hearings on H.R. 6778*, *supra*, at 13, 205-207 (Remarks of Prof. Berle and Board Vice-Chairman Robertson).

[45] H.R. Rep. No. 1747, 91st Cong., 2d Sess. 19-21, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5572-5573. This two-tiered test "has been adopted and endorsed by every circuit to consider the question." *See Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, *supra*, 568 F.2d at 552, and cases cited therein.

But where, as we have seen, Congress expressly made it *unlawful* for national or state member banks to organize, sponsor, or manage *any* investment company, it can neither be "banking," nor "closely related to banking," nor a "*proper* incident" of banking, for banks to avoid these legal constrictions by utilizing nonbank sister companies to organize, sponsor or manage investment companies.

The Board conceded as much itself, in its testimony supporting the 1970 amendments to the Bank Holding Company Act. *Then*, the agency expressed "deep concern" about the "unchecked" increase of one-bank holding companies, because "bank holding companies should be congenerics, not conglomerates." Indeed, the Board acknowledged that the Bank Holding Company Act "*limited*," rather than expanded, the activities of bank holding companies, and "unanimously" concluded then, as the court below does now, that the Bank Holding Company Act "reinforced" the Glass-Steagall Act's "essential" function of "separating banking *and commerce* . . . ."[46]

The Board's contrary assertion now—that the Bank Holding Company Act somehow *authorizes* banks to do indirectly what it is unlawful or improper for banks to do directly—not only flies in the face of the statute, it also proves too much. If the Board's position were correct—which it is not—the Board presumably could authorize banks to sponsor a whole range of securities enterprises, such as brokerage firms, or open-end investment companies, through the vehicle of nonbank sister

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[46] House Committee on Banking and Currency, *Hearings on H.R. 6778*, *supra* at 196 (Statement of W. McChesney Martin, Jr., Board Chairman) (emphasis supplied).

affiliates, a result that would emasculate the very fiber and structure of the Glass-Steagall Act.[47]

In short, if an activity is forbidden to a national or state member bank, it impermissibly exalts form over substance to argue, as the Board does, that Congress intended the same activity to be "closely related" to banking;[48] and, it strains credulity even more to suppose

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[47] The Board argues in its brief (Br. 55) that investment advisory services are "closely related" to banking because "bank trust departments have traditionally organized and managed large collective investment funds such as common trust funds . . . ." As this Court has pointed out, however, while it is not improper for a bank "to pool trust assets, or to act as a managing agent for individual customers, or to purchase stock for the account of its customers . . . the union of these powers gives birth to [an activity] of a different character." *Investment Company Institute* v. *Camp, supra*, 401 U.S. at 625. The first three enumerated activities are, as the Board notes (Br. 55), "conventional fiduciary services"; the last, combined activity, however, is one that is not only not "related to banking," but one which is forbidden to banks. The Board's articulated test is doubly pernicious, however, since it is also a "conventional fiduciary activity" for a bank to purchase and sell securities for the account of a customer as an accommodation service, and the Board's test, if applied as articulated, could permit a bank holding company affiliate to hold itself out to the public as a securities broker. It cannot be gainsaid that banks are prohibited from engaging in such a business, which, *perforce*, cannot be "closely related" to banking.

[48] An activity is "closely related" to banking if "*banks* generally have in fact provided the proposed service," or the services are so inseparably related or similar to the services banks perform that they can only be provided in a specialized form by banks. *Nat'l Courier Ass'n* v. *Board of Governors, supra*, 516 F.2d at 1237 (emphasis supplied); *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (C.A. 4, 1979). As this Court indicated in *Mitchell* v. *H. B. Zachry Co.*, 362 U.S. 310, 319 (1960), the term "closely related," when used in other statutory schemes, implies elements of both necessity and close proximity. Since the enactment of the Glass-Steagall Act, banks have not sponsored closed-end funds (Securities and Exchange Commission, *Report on Investment Trusts and Investment Companies, supra*, pt. 2, p. 59; Br. for respondent at 72-73, *citing*, Weisenberger, *Investment Companies Service;* under the circumstances, bank sponsorship of closed-end funds cannot satisfy the stringent elements of the "closely related" test.

that a forbidden activity can be a "proper" incident of banking if pursued through a wholly-controlled or affiliated sister company.[49] Not surprisingly, the Board cites no authority for such a proposition.[50]

C. Relevant Policy Considerations Confirm that Bank Holding Companies May Not Organize, Sponsor, or Manage Closed-End Investment Companies

In *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 630, this Court noted that the "legislative history of the Glass-Steagall Act shows that Congress . . . had in mind and repeatedly focused on the more subtle hazards that arise when a commercial bank . . . enters the investment banking business either directly or by establishing an affiliate to hold and sell particular in-

[49] An activity that violates one provision of law cannot be deemed to be a "proper" activity in which a bank holding company may engage under federal banking law. *Cf. Independent Bankers Ass'n* v. *Board of Governors*, 516 F.2d 1206, 1222 (C.A. D.C., 1975).

[50] The Board argues (Br. 57) that *it* can evaluate whether, in the case of any particular application to sponsor a closed-end fund, the grant of that application can be expected to produce public benefits that outweigh such potential adverse effects as "undue concentration of resources, decreased or unfair competition, or unsound banking practices." But, this argument ignores the fact that, where the securities business is concerned, considerations of "competition, convenience, and expertise" are irrelevant, even where a convincing argument can be made in support of allowing commercial banks to engage in such activities. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 636.

vestments."[51] After assessing the operation of investment companies by banks in the light of these evils, this Court there concluded that "[t]hose same hazards are *clearly* present when a bank undertakes to operate an investment fund." *Id.* at 636 (emphasis supplied).

Although the plain meaning of the Glass-Steagall Act and the Bank Holding Company Act evidences Congress' intent to bar bank holding companies from serving as investment advisers to closed-end investment companies, and makes resort to the legislative history of the banking statutes unnecessary, a review of the "subtle" dangers the Glass-Steagall Act sought to avert confirms the plain meaning, and applicability, of the statute here, and demonstrates why the Board's regulation and interpretive ruling are inadequate to assure against a repetition of the abuses that led to the adoption of this federal banking legislation.

There can be no dispute, and the Board here concedes (Br. 31-32), that the "conflicts of interest and unsound banking practices of the kind" discussed in *Camp*, and which the Congress sought to proscribe by

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[51] Among other things, the Glass-Steagall Act reflected Congress' express concern that: (i) the close affiliation between banks and their securities affiliates might lead to a loss of public confidence in the bank if the fortunes of the securities affiliate flagged; (ii) banks might attempt to shore up their securities affiliates through unsound and unsafe lending and credit practices; (iii) banks might be inclined to lend their good names to the sales efforts of their securities affiliates; (iv) banks might attempt to spur sales by improperly lending customers funds to invest in securities being sold by bank securities affiliates; (v) a conflict might arise between the promotional incentives of the bank and its securities affiliate, and the need for the bank to render disinterested investment advice to its loan customers; and (vi) the bank securities affiliates might utilize bank trust departments to unload excessive or undesirable securities holdings. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629-634.

adopting the Glass-Steagall Act, may be engendered when bank holding companies act as investment advisers to closed-end investment companies. This concession is compelling confirmation of the need for the application of the Glass-Steagall Act here. *Investment Company Institute* v. *Camp*, *supra*, 401 U.S. at 629-636.

Moreover, the force and impact of the Board's concession is, if anything, heightened by the Board's response to these potential "conflicts of interest and unsound banking practices." Rather than accept Congress' determination that any affiliations between the banking and securities industries be prohibited outright, the Board arrogated to itself the power to override Congress' mandate, and adopted a handful of inneffectual, and legally irrelevant, "safeguards" (Br. 31) to restrict some (but by no means all) of the more blatant "conflicts of interest and unsound banking practices."[52]

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[52] The Board's interpretative ruling does nothing to prevent a bank holding company or its bank and nonbank subsidiaries from aggressively promoting the securities in the advisee's portfolio, or from making unsound loans to those companies. For example, the Board's "safeguards" do not protect against imprudent securities investments or lending by bank subsidiaries to those companies whose securities the subsidiary investment company has purchased, and the consequential risk to bank assets. The Board did nothing to prohibit bank subsidiaries from selectively denying credit to competitors of companies whose securities the fund owns. Moreover, the Board did not prohibit a bank subsidiary from using its reputation to recommend or promote particular stocks and securities in the investment company's portfolio, or from making loans to customers to facilitate the purchase of such securities. Nor did the Board prohibit a subsidiary bank from disclosing confidential information about its customers to its affiliated investment adviser. Finally, the Board's ruling would permit a bank to use its resources to achieve the kind of centralized economic power that Congress sought to prevent. The presence of *any one* of these significant problems would be sufficient reason for this Court to affirm the decision of the court below.

But, had Congress sought to authorize the bank regulatory agencies to attempt to develop, in an *ad hoc* fashion, "safeguards" that might (or might not) be sufficient to prevent the abuses with which Congress was concerned, there would be no need now to imply such a remedy: Congress surely knew how to create one expressly.[53] The fact that Congress did *not* vest the Board with such express powers leaves the Board's interpretive release without any predicate in law or policy for attempting to condone illegal conduct by mildly restricting some of the ways in which that illegal conduct can be perpetrated.[54]

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[53] *See, e.g., Touche Ross & Co.* v. *Redington, supra*, 442 U.S. at 572; *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 734.

[54] The Board lamely responds (Br. 57) to the court of appeals' conclusion that the same speculative abuses discussed in *Camp* could arise here, by complaining that "[t]he court does not explain why the commercial department of a bank would behave in this way." But, the fact is that "*Congress* feared that banks might even go so far as to make unsound loans" to companies in which their *affiliates* had invested. *Investment Company Institute* v. *Camp, supra*, 401 U.S. at 631 (emphasis supplied). We doubt that the court of appeals owes the Board any further explanation of the rather obvious possibilities for abusive conduct in this area; but, in any event, this Court, in citing the same abuses in *Investment Company Institute* v. *Camp, supra*, surely provided a full and adequate explanation.

CONCLUSION

When Congress enacted the Glass-Steagall Act, it intended to, and did, separate commercial banking from the securities business. Despite this clear mandate, the bank regulatory agencies have repeatedly attempted to encourage or permit banks to encroach into areas of the securities business which the law clearly prohibits. The court below acknowledged this fact and adhered to its clear duty to confine banks to their legitimate activities by declaring the Board's regulations and interpretive ruling invalid. For all of the foregoing reasons, this Court should affirm the judgment of the court below.

Respectfully submitted,

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Re: Board of Governors of the
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Dear Mr. Pitt:

I hereby consent on behalf of the Investment Company Institute to your filing an amicus brief in the Supreme Court on behalf of A.G. Becker, Incorporated in the case of *Board of Governors of the Federal Reserve System* v. *Investment Company Institute.*

Sincerely,

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May 5, 1980

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Re: Board of Governors of the Federal Reserve System v. Investment Company Institute, No. 79-927

Dear Mr. Schropp:

In response to your letter of April 29, 1980, I hereby consent, on behalf of the petitioner, to the filing of a brief *amicus curiae* on behalf of A. G. Becker Incorporated in this case.

Sincerely yours,

WADE H. MCCREE, JR.
Solicitor General

Supreme Court, U.
FILED
MAY 12 1980
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION, BANKAMERICA CORPORATION, AND WESTERN BANCORPORATION AS *AMICI CURIAE*

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF THE AMERICAN BANKERS ASSOCIATION, THE NEW YORK CLEARING HOUSE ASSOCIATION, BANKAMERICA CORPORATION, AND WESTERN BANCORPORATION AS *AMICI CURIAE*

INTEREST OF *AMICI CURIAE*

The American Bankers Association, The New York Clearing House Association, BankAmerica Corporation, and Western Bancorporation, with the consent of the parties, submit this brief *amici curiae* in support of the petitioner. The *amici* have a substantial and immediate interest in this case, which presents an important question concerning the meaning and application of two major federal banking statutes. The American Bankers

Association is the principal trade association of the commercial banking industry. The New York Clearing House Association is an association of twelve major commercial banks, each of which is owned by a bank holding company subject to regulation by the Federal Reserve Board. BankAmerica Corporation and Western Bancorporation are bank holding companies subject to regulation by the Board; each has a nonbanking subsidiary that serves as investment adviser to a registered closed-end investment company pursuant to the regulation the validity of which is at issue in this case.

QUESTION PRESENTED

Whether the Federal Reserve Board's adoption of a regulation and interpretive ruling that permit bank holding companies and their nonbank subsidiaries, subject to specified limitations, to sponsor, organize, manage, and control closed-end investment companies is a valid exercise of the Board's authority under section 4(c)(8) of the Bank Holding Company Act and is consistent with the constraints imposed on the activities of bank holding companies by the Glass-Steagall Act.

STATEMENT

1. *Investment companies and investment advisers.* An investment company is a "corporate or business trust medium which pools the investment funds of many persons, generally of moderate means, and invests these pooled investment funds in a diversified portfolio of securities . . . under continuous professional supervision." [1] Investment companies can be either "open-end" or "closed-end." Open-end investment companies (commonly called "mutual funds") are, typically, continuously engaged in

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[1] Investment Company Institute, *Management Investment Companies* 1 (1962).

raising new capital through the issuance of additional shares; they stand ready at any time to redeem their outstanding shares. By contrast, closed-end investment companies have an essentially fixed capitalization and, typically, do not issue additional shares after their initial organization; they do not stand ready to redeem their shares.[2]

Most investment companies are organized and managed by their investment advisers. An investment adviser regularly furnishes investment advice to, or determines the securities or other property to be purchased or sold by, the investment company. In addition, it generally maintains records, handles administrative matters, and performs management tasks:

> The management of [an investment company] is largely in the hands of an investment adviser, an independent entity which generally organizes the fund and provides it with investment advice, management services, and office space and staff. The adviser either selects or recommends the fund's investments and rate of portfolio turnover, and operates or supervises most of the other phases of the fund's business.[3]

2. *The Board's adoption of the regulation.* A "bank holding company" is a company that has control over a bank. Section 2(a)(1) of the Bank Holding Company Act of 1956, *as amended*, 12 U.S.C. § 1841(a)(1). Section 4(a) of the Bank Holding Company Act prohibits a bank holding company from acquiring ownership of any entity other than a bank or from engaging in any business other than banking. 12 U.S.C. § 1843(a). Section 4(c)(8) of the Act, however, authorizes the Board

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[2] *See, e.g., id.* at 3; 12 C.F.R. § 225.125(c).

[3] *Tannenbaum* v. *Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). *See generally* 1 T. Frankel, *The Regulation Of Money Managers* 6-21 (1978).

of Governors of the Federal Reserve System to except from that prohibition activities the Board "has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).

After notice and hearing,[4] the Board determined, by regulation, that "serving as investment adviser, as defined in § 2(a)(20) of the Investment Company Act of 1940, to an investment company registered under that Act" is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. 12 C.F.R. § 225.4(a)(5)(ii), 37 Fed. Reg. 1463 (Jan. 29, 1972). At the same time, the Board issued an interpretive ruling specifying what activities were prohibited, and what activities were allowed, to bank holding companies or their nonbank subsidiaries serving as investment advisers.[5]

The Board prohibited two classes of activities. *First*, in order to avoid "potential conflicts of interests," the Board prohibited bank holding companies (as well as their bank and nonbank subsidiaries) from purchasing for their own or for discretionary accounts securities of the investment companies they advise, extending credit to such investment companies, or accepting securities of such investment companies as collateral for loans for the purchase of additional securities of those investment companies. 12 C.F.R. § 225.125(g).[6] *Second*, the Board

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[4] *See* 36 Fed. Reg. 16695 (Aug. 25, 1971) (notice of proposed rulemaking); 36 Fed. Reg. 20779 (Oct. 29, 1971) (hearing held and comments received).

[5] Except where the context indicates otherwise, the expression "bank holding company" will be used to include both the holding company and its nonbank subsidiaries.

[6] The Board imposed additional prohibitions to deal with "potential conflicts of interests" that it felt might arise in

prohibited a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12 C.F.R. § 225.125(h). The Board stated that a bank holding company may not distribute sales literature of the investment company or make such literature available at its offices, and that personnel of the holding company's bank subsidiaries may not express any opinion on the advisability of purchasing the investment company's securities. 12 C.F.R. § 225.125(h).[7]

Subject to those limitations, the Board allowed a bank holding company serving as investment adviser to a closed-end investment company to perform the full range of functions traditionally performed by such advisers (including sponsoring, organizing, managing, and controlling the closed-end investment company), provided that the closed-end investment company is not "primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f).[8]

3. *The Board's denials of respondent's petitions for reconsideration.* In December 1973 and again in March 1977, respondent Investment Company Institute, a trade association of open-end investment companies, petitioned

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situations where a bank holding company acts both as custodian and investment adviser for an investment company. 12 C.F.R. § 225.125(i).

[7] In addition, the Board prohibited a bank holding company from acting as investment adviser to an investment company that, either because of its name or office location, might be identified with the bank holding company or any of its subsidiary banks. 12 C.F.R. §§ 225.125(f), (h).

[8] The Board also allowed bank holding companies to serve as investment advisers to open-end investment companies, but did not authorize them to sponsor, organize, manage, or control such companies. 12 C.F.R. § 225.125(f).

the Board to reconsider and rescind its determination that serving as an investment adviser is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. The Board denied both petitions.[9]

Respondent's principal argument before the Board was that bank holding companies would violate section 21 of the Glass-Steagall Act, 12 U.S.C. § 378, if they served as investment advisers. The Board disagreed, stating that the prohibitions contained in section 21 apply only to banks, not to bank holding companies,[10] and that in any event the specific activities permitted to bank holding companies under its regulation are not prohibited to banks:

> In considering the permissibility of investment advisory activity for bank holding companies, the Board was especially careful to limit the scope of the permitted activity to investment advisory services, which has been a traditional banking function as long as there have been banks.

Pet. App. D, p. 57a. Respondent also argued that banks would violate section 16 of the Glass-Steagall Act, 12

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[9] Pet. App. D, pp. 53a-64a; Pet. App. E, pp. 65a-79a. Following the Board's denial of the first petition, respondent sought review in the United States District Court for the District of Columbia. The district court dismissed the action on the ground that exclusive jurisdiction lay in the courts of appeals, and the court of appeals affirmed. *Investment Company Institute* v. *Board of Governors*, 398 F. Supp. 725 (D.D.C. 1975), *aff'd*, 551 F.2d 1270 (D.C. Cir. 1977). Respondent thereupon filed its second petition with the Board.

[10] In this connection, the Board noted that Congress, in enacting the 1970 amendments to the Bank Holding Company Act, "clearly" intended to empower the Board "to authorize bank holding companies to engage in activities that could not be conducted by banks directly." Pet. App. D, p. 56a.

U.S.C. § 24 Seventh, if they acted as investment advisers, but the Board pointed out that its regulation authorized only nonbank entities in the holding company system to act as investment advisers. Pet. App. D, pp. 60a-61a.

As for that part of its regulation dealing specifically with closed-end investment companies, the Board stated:

> [B]ank holding companies may affiliate with closed-end investment companies only "as long as such companies are not primarily or frequently engaged in the issuance, sale and distribution of securities."] This is consistent with—and even stricter than—the provision of section 20 of the Glass-Steagall Act which merely prohibits affiliations with a member bank where a [bank holding] company is "engaged principally" in securities activities.

Pet. App. E, p. 77a. At no time had respondent urged that the Board's regulation was inconsistent with section 20 of the Glass-Steagall Act.

4. *The court of appeals' decision.* Upon review, the United States Court of Appeals for the District of Columbia Circuit invalidated the Board's regulation and ruling. The court did not disapprove the Board's factual determination that serving as an investment adviser to a closed-end investment company is "closely related to banking" within the meaning of section 4(c)(8) of the Bank Holding Company Act. Instead, the court concluded that the regulation lay outside the Board's power under the Bank Holding Company Act.

The court of appeals believed that the Board's regulation conflicted with the "Glass-Steagall Act's overarching policy," Pet. App. A, p. 30a, which the court apparently viewed as barring banks and their affiliates from engaging in what it classified broadly as "the securities business" or "securities activities." *See, e.g.*, Pet. App. A, pp. 28a, 43a. The court did not determine,

however, that the Board's regulation and ruling authorized bank holding companies to engage in activities prohibited to them by the Glass-Steagall Act. The court held that the regulation was consistent with sections 16 and 21 of the Act.[11] The court "intimate[d] no views" as to the applicability of sections 20 and 32 of the Act. *Id.* at 44a. Nor did the court decide that the regulation would have violated former section 19(e) of the Glass-Steagall Act, had that provision not earlier been repealed. *Id.* at 23a.

The court's holding nevertheless reflected its view of former section 19(e). The court appeared to derive from that provision an implicit, nontextual limitation on the Board's power under section 4(c)(8) of the Bank Holding Company Act. *See id.* at 29a-32a, 43a.

The court of appeals thus treated the actual reach of the Glass-Steagall Act as immaterial. In the court's view, what was "important" to its inquiry was not what the Glass-Steagall Act's language stated, but rather "what subsequent Congresses *thought* that Act to have meant." *Id.* at 28a (emphasis in original). The court concluded that later Congresses "*perceived* the Glass-Steagall Act as prohibiting securities activities by bank holding companies and their non-bank subsidiaries." *Id.* at 44a (emphasis in original); *see also id.* at 31a. The court recognized that "Congress may have been mistaken in its perception," but regarded that possibility as irrelevant to the issues before it. *Id.* at 44a.

Because neither party had suggested the line of analysis followed by the court, *see id.* at 24a, the Board was

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[11] *Id.* at 14a-23a. The court held that the prohibitions of section 21 of the Glass-Steagall Act apply only to banks and not to bank holding companies or their nonbank subsidiaries. *Id.* at 17a-20a. As for section 16, the court noted that respondent had conceded that it applied "only [to] the activities of banks, and not of other entities within the holding company structure." *Id.* at 21a.

unable to address the court's approach until it filed a petition for rehearing. The court denied the petition but, *sua sponte*, modified its opinion to state that it was not deciding "the question of whether bank holding companies and their non-bank subsidiaries may . . . render solely investment advice to closed-end investment companies, as distinct from sponsoring, organizing, managing, or controlling such companies." *Id.* at 48a-49a.

INTRODUCTION AND SUMMARY OF ARGUMENT

The sole issue in this case is the validity of a regulation and interpretive ruling by which the Federal Reserve Board, pursuant to its authority of section 4(c)(8) of the Bank Holding Company Act, authorized bank holding companies to serve as investment advisers to closed-end investment companies, and in that capacity to perform (subject to specified limitations) the functions customarily performed by investment advisers. 12 C.F.R. §§ 225.4(a)(5)(ii), 225.125. The regulation and ruling rested upon the Board's determination that serving as investment adviser to an investment company registered under the Investment Company Act of 1940 is "so closely related to banking . . . as to be a proper incident thereto" within the meaning of section 4(c)(8).

There is no dispute as to the correctness of the Board's factual determination. As the Board noted, Pet. App. D, p. 57a, banks have long performed the kinds of functions that the Board has authorized bank holding companies to perform for closed-end investment companies. Banks sponsored and managed closed-end investment companies both before and after enactment of the Glass-Steagall Act.[12] In addition, banks have long operated common trust and commingled pension funds,

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[12] SEC, *Report on Investment Trusts and Investment Companies, Part 2*, H.R. Doc. No. 70, 76th Cong., 1st Sess. 57-59, 124 (Table 25) (1939) (*"Investment Company Report"*).

which function like investment companies,[13] and banks have traditionally offered a full range of investment advisory and management services to such funds. Those services include organizing the fund (including bearing the costs of organization and obtaining necessary authorizations for the fund to do business); performing record-keeping and other administrative responsibilities; managing the fund's investment portfolio (including establishing the fund's investment policies, rendering investment advice to and making investment decisions for the fund, and retaining brokers and issuing orders for purchases and sales of securities); arranging for audits and satisfying reporting requirements; and generally exercising exclusive management of the fund.[14]

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[13] *See* H. Bullock, *The Story Of Investment Companies* 75 (1959); 1 T. Frankel, *supra* n.3, at 422-23; SEC, *Report on Investment Trusts and Investment Companies, Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies*, H.R. Doc. No. 476, 76th Cong., 1st Sess. 3-4 (1939). The Board formally authorized national banks to organize and manage common trust funds in 1937, and since then over forty states have adopted laws permitting state chartered banks to operate such funds. *Id.* at 25; *see also, e.g.*, 7 U.L.A. Business & Fin. Laws 15 (Supp. 1980) (Uniform Common Trust Fund Act). In 1955, the Board further permitted banks to commingle the trust assets of their pension and employee benefit plan clients. 20 Fed. Reg. 3305 (May 14, 1955), 12 C.F.R. § 9.18(a)(2). By the time the Board promulgated the regulations challenged in this case, the nation's 50 largest banks had organized and were actively managing over 350 common trust funds and commingled pension funds. SEC, *Institutional Investor Study Report*, H.R. Doc. No. 64, 92d Cong., 1st Sess. 417 (Table V-1) (1971).

[14] Banks perform a number of these services pursuant to requirements of state and federal law. *See, e.g.*, 12 C.F.R. §§ 9.18(b)(1)-(12); I.R.C. § 6032; N.Y. Banking Law § 100-c (McKinney 1971); N.Y. Banking Board, General Regulations, ch. I, part 22.

In organizing, operating, and managing common trust and commingled pension funds, banks provide investment advisory services of the kind that the Board has authorized bank holding companies to perform. The issue presented here is whether, notwithstanding the close relationship between the activities authorized by the Board and those in which banks routinely engage, the Board lacks authority under section 4(c)(8) to permit bank holding companies to engage in such activities.

* * * * *

The Board's regulation was well within the broad authority conferred by section 4(c)(8) of the Bank Holding Company Act, and nothing in the Glass-Steagall Act renders the Board's regulation invalid.

1. The Board's regulation is consistent with the Glass-Steagall Act. Sections 16 and 21 of that Act, 12 U.S.C. §§ 24 Seventh and 378, apply only to banks, not to bank holding companies. Section 20 of the Glass-Steagall Act, 12 U.S.C. § 377, which is the sole provision of the Act that limits the activities of bank holding companies, prohibits such companies only from engaging "principally" in "the issue, flotation, underwriting, public sale, or distribution" of securities. Neither an investment adviser nor an investment company operating under the Board's regulation runs afoul of this provision.

A bank holding company that serves as investment adviser to a closed-end investment company in the manner authorized by the Board is not engaged at all, let alone "principally," in the activities forbidden to bank affiliates by section 20 of the Glass-Steagall Act. The statutory phrase "issue, flotation, underwriting, public sale, or distribution" of securities refers to securities underwriting activities of the kind traditionally conducted by investment banking houses. *Board of Governors* v. *Agnew*, 329 U.S. 441, 445 & n.3 (1947). Under the Board's regulation and ruling, a bank holding company

may not engage in such activities. The ruling expressly prohibits a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12 C.F.R. § 225.125(h).

Nor is a closed-end investment company for which a bank holding company may serve as investment adviser "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. By their very nature, closed-end investment companies are not "principally" engaged in the underwriting, distribution, or issuance of securities; indeed, their distinguishing feature is that they do not regularly issue shares. 12 C.F.R. § 225.125 (c). Furthermore, the Board's ruling allows bank holding companies to organize and manage only closed-end investment companies that are "not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f).

Section 10(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-10(c), confirms that closed-end investment companies are not "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. In section 10(c), Congress approved the continuation of existing affiliations between banks and closed-end investment companies—something it would not have done if such affiliate relationships were barred by the Glass-Steagall Act. Congress' decision to allow banks to participate in the management of closed-end investment companies expresses a policy that supports, rather than conflicts with, the Board's determination.

2. The challenged regulation lies well within the Board's authority under section 4(c)(8) of the Bank Holding Company Act. In that provision, Congress, relying upon the Board's expertise and familiarity with the banking industry, granted the Board broad power to permit bank holding companies to engage in those nonbank-

ing activities that the Board finds to be "closely related to banking." Section 4(c)(8) contains no special limitations with respect to securities activities. The legislative history of the Bank Holding Company Act and its amendments does not suggest any implied, nontextual limitation on the Board's authority. Nor can such a limitation be derived from former section 19(e) of the Glass-Steagall Act.

ARGUMENT

THE BOARD'S REGULATION PERMITTING BANK HOLDING COMPANIES TO ORGANIZE, SPONSOR, MANAGE, AND CONTROL CLOSED-END INVESTMENT COMPANIES IS VALID

The Board's regulation and ruling were adopted pursuant to section 4(c)(8) of the Bank Holding Company Act, which confers broad authority upon the Board to permit bank holding companies to engage in activities "so closely related to banking . . . as to be a proper incident thereto." The focus of this litigation throughout, however, has been on the Glass-Steagall Act. Respondent's principal arguments have been that the activities permitted by the Board violate prohibitions of the Glass-Steagall Act, *see* pp. 6-9 *supra*, and the decision of the court of appeals is rooted in the court's understanding that "the Glass-Steagall Act's overarching policy" was to "divorc[e] investment from commercial banking." Pet. App. A, p. 30a.

The court's description of the "policy" of the Glass-Steagall Act was oversimplified: although the Act proscribes the underwriting of non-governmental securities by banks, the statute specifically permits banks to engage in the underwriting of governmental securities.[15] In any

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[15] Congress has allowed banks to underwrite "obligations of the United States [and] general obligations of any state or of any political subdivision thereof," and also obliga-

event, even the "policy" identified by the court of appeals would not be affronted by what the Board has done here: an investment company is not an investment bank, and a bank holding company is not a commercial bank. Moreover, a legislative policy is applied by enforcing "the language of the statute itself." *Transamerica Mortgage Advisers* v. *Lewis*, 100 S.Ct. 242, 245 (1979). And nothing in the language of the Glass-Steagall Act prohibits the activities that the Board has authorized bank holding companies to perform.

I. The Glass-Steagall Act Does Not Prohibit A Bank Holding Company From Serving As Investment Adviser To A Closed-End Investment Company In The Manner Authorized By The Board

A. *The Only Provision Of The Glass-Steagall Act That Imposes Restrictions On The Activities Of Bank Holding Companies Is Section 20*

The Glass-Steagall Act contains four distinct provisions designed to achieve the objective of separating commercial banking from the underwriting of nongovernmental securities:

> (1) section 16 of the Act, 12 U.S.C. § 24 Seventh, prohibits a national or state member bank from engaging in the underwriting of nongovernmental securities and from dealing in such securities for its own account;[16]
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> (2) section 21 of the Act, 12 U.S.C. § 378, prohibits any person engaged in the business of "issuing, underwriting, selling, or distributing" non-

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tions issued under a wide variety of state and federal programs and obligations issued by certain international agencies. *See* 12 U.S.C. § 24 Seventh.

[16] By its terms, section 16 applies only to national banks. Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, makes section 16 applicable to state member banks.

governmental securities from engaging "to any degree whatever" in commercial banking;

(3) section 20 of the Act, 12 U.S.C. § 377, prohibits "affiliation" [17] between a member bank and any person engaged "principally" in the "issue, flotation, underwriting, public sale, or distribution" of securities; and

(4) section 32 of the Act, 12 U.S.C. § 78, prohibits officer, director or employee interlocks between a member bank and a company engaged "primarily" in the activities described in section 20.

In addition, former section 19(e) of the Act, 48 Stat. 188, which was repealed in 166, 80 Stat. 242-43, prohibited a bank holding company from voting the shares of any bank if the holding company also held an interest in a company engaged "principally" in the activities described in section 20.

Thus, in the Glass-Steagall Act Congress carefully distinguished between banks and bank affiliates and prescribed different rules for each. Whereas in sections 16 and 21 Congress prohibited banks from *any* involvement in the underwriting of non-governmental securities and from dealing in such activities as a principal,[17] Congress chose not to impose such sweeping prohibitions on the securities activities of bank affiliates. Section 20,

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[17] Section 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b), defines "affiliate" as any entity (1) owned or controlled by the bank, (2) under common control with the bank, (3) a majority of whose directors also are directors of the bank, or (4) that owns or controls the bank. The fourth category, of course, covers a bank holding company; the second category covers, *inter alia*, a bank holding company's nonbanking subsidiaries. The fourth category was added by amendment in 1966. 80 Stat. 242-43. Before 1966, therefore, section 20 applied to a bank holding company's nonbanking subsidiaries but not directly to a bank holding company itself.

which deals directly with bank affiliates, prohibits such affiliates only from engaging "principally" in issuing, underwriting, selling, or distributing securities. The qualifying term "principally" "mark[s] a distinction which . . . should not [be] obliterate[d]. . . ." *Board of Governors* v. *Agnew*, 329 U.S. 441, 448 (1947).[18]

Sections 16 and 21 of the Glass-Steagall Act have no application here. The Board's regulation grants no authority to banks. Pet. App. A, pp. 22a-23a. It authorizes certain bank *affiliates* to sponsor, organize, manage, and control closed-end investment companies. Respondent has conceded that section 16 places no restrictions on bank holding companies or other bank affiliates, *id.* at 21a, and both the Board and the court of appeals correctly de-

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[18] The court of appeals wrongly suggested, Pet. App. A, p. 26a, that Congress did not mean to draw a significant distinction between banks and bank affiliates in the Glass-Steagall Act. *See Board of Governors* v. *Agnew*, 329 U.S. at 447-48. The legislative history of the Glass-Steagall Act demonstrates that Congress used the term "principally" in section 20 with full awareness of the distinction it signified. As initially proposed, section 21 of the Glass-Steagall Act prohibited various business organizations "engaged *principally* in the business of issuing, underwriting, selling, or distributing" securities from also being involved in commercial banking. S. 1631, 73d Cong., 1st Sess. § 21(a)(1) (May 1, 1933) (emphasis added). *Accord*, H.R. 5661, 73d Cong., 1st Sess. § 17(a)(1) (May 17, 1933). The word "principally" was stricken from this provision in a floor amendment offered by Senator Bulkley, a major proponent of the bill, who was concerned that, as proposed, the provision might not achieve the aim of separating commercial banking from the underwriting of non-governmental securities. *See* 77 Cong. Rec. 4180 (1933). In contrast, Congress retained the term "principally" in section 20, thereby making clear that that provision did not impose on bank affiliates the absolute prohibition that was made applicable to banks themselves.

termined that section 21 also applies only to banks and not to bank affiliates. Pet. App. D, pp. 54a-56a; Pet. App. A, pp. 14a-21a.[19]

Section 20, which does apply to bank affiliates, provides that

> no member bank shall be affiliated . . . with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . .

Section 20 is the sole provision of the Glass-Steagall Act that imposes restrictions on the business activities of bank affiliates.[20] To the extent that the Glass-Steagall Act articulates a congressional policy concerning the conduct of securities activities by bank affiliates, that policy is expressed by section 20. Neither that policy nor the express prohibitions of section 20 are contravened by the Board's regulation.

B. *An Investment Adviser Operating Within The Limits Prescribed By The Board Is Not Engaged Principally In The Activities Described In Section 20 Of The Glass-Steagall Act*

An investment adviser that operates within the limits prescribed by the Board is not engaged principally in "the issue, flotation, underwriting, public sale, or distri-

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[19] Because sections 16 and 21 of the Glass-Steagall Act do not apply to bank holding companies, this case differs significantly from *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), which involved the application of those provisions to banks.

[20] The focus of section 32 of the Act is on the existence of director and employee interlocks between a bank and a company that, whether or not otherwise affiliated with the bank, is "primarily" engaged in the underwriting activities also described in section 20.

bution" of securities within the meaning of section 20 of the Glass-Steagall Act. This Court already has had occasion, in its decision in *Board of Governors* v. *Agnew*, to construe this statutory phrase, which appears in both section 20 and section 32 of the Act: contrary to the apparent understanding of the court of appeals, Pet. App. A, p. 44a, the statutory phrase does not cover all securities activities, or even "the brokerage business," but only "the underwriting field." 329 U.S. at 445 & n.3.[21] Consistent with this reading, the Board has long taken the position that "executing orders for the purchase and sale of securities on behalf of others in the open market" does not constitute "the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of the Glass-Steagall Act. 12 C.F.R. § 218.1 n.1 (derived from 12 C.F.R. § 218.1 n.95 (1939)).

This Court's determination in *Agnew* that the statute refers specifically to underwriting activities and not to securities activities generally is grounded in the statu-

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[21] The issue in *Agnew* was whether Eastman, Dillon & Co. was "primarily" engaged in "the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 32. The firm's major business activity was brokerage, but it also was significantly involved in underwriting; together, the two securities activities produced well over 50 percent of the firm's gross income. 329 U.S. at 445. This Court understood that brokerage was not included among the securities activities described in the statute; the Court specifically addressed the question whether Eastman, Dillon was "primarily" engaged "in underwriting" even though its "underwriting business did not by any quantitative test exceed 50 per cent of its total business . . . ." 329 U.S. at 446. The Court concluded that "[i]f the underwriting business of a firm is substantial, the firm is engaged in the underwriting business in a primary way, though by any quantitative test underwriting may not be its chief or principal activity." *Id.*

tory language itself, the legislative history of section 20, and the informed contemporaneous understanding of the Glass-Steagall Act. The statutory phrase "issue, flotation, underwriting, public sale, or distribution" of securities precisely describes the securities underwriting activities of investment bankers.[22] This language derived from an earlier legislative proposal drafted by the Federal Reserve Board, the purpose of which was "to separate commercial banking from investment banking."[23] Section 20

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[22] The only word that might seem out of place today when discussing investment banking is "issue." But at the time the statute was drafted, investment banking was frequently described as the business of "originating" or "issuing" the securities of others, just as investment banking houses were then referred to as "houses of issue." *See, e.g., Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 35, 241 (1931) ("*S. Res. 71 Hearings*"); *Hearing on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess. 28, 33 (1932) ("*S. 4115 Hearings*"); S. Rep. No. 1455, 73d Cong., 2d Sess. 117 (1934); 75 Cong. Rec. 9909 (1932). Thus, each word in the statutory phrase was designed to connote the origination, distribution, and marketing of securities for a profit—the investment banking business. *See generally* 1 L. Loss, *Securities Regulation* 160, 164, 167 n.14 (1961).

[23] *S. 4115 Hearings, supra* n.22 at 393 (statement of Governor Meyer of the Federal Reserve Board). *See also id.* at 385, 388, and 417. Senate hearings held the previous year had shown that bank "securities affiliates" that engaged in investment banking operations formed one of the chief connections between commercial banks and the securities markets. *S. Res. 71 Hearings, supra* n.22, at 999. Although some of these affiliates engaged in a wide variety of functions, they were generally in the business of acting either as wholesalers of securities issues (by purchasing entire offerings themselves or by joining with other similar companies to acquire whole issues of securities) or as retailers of securities (by distributing securities to institutional and private investors). *Id.* at 1057-60; 75 Cong. Rec. 9909 (1932).

itself was specifically intended to terminate affiliations between banks and "corporations operating in the long-term capital market in competition with the investment houses, typically unincorporated, that have traditionally done most of the business in that market." [24] The subsequent study by the Securities and Exchange Commission that led to the enactment of the Investment Company Act in 1940 also expressed the same understanding—that section 20 barred banks from affiliating with securities firms "comparable to houses of issue," *i.e.*, "[f]irms whose primary business was the origination of securities in connection with their primary distribution." *Investment Company Report, supra* n.12, at 57 & n.38 (definition of "bank affiliate"). Thus there was ample basis and reason for this Court's determination that "[s]ection 20 of the Act outlaws affiliation of a member bank with an organization 'engaged principally' in the *underwriting* business." *Board of Governors* v. *Agnew*, 329 U.S. at 447 (emphasis added; footnote omitted).[25]

A bank holding company that serves as investment adviser to a closed-end investment company in the manner authorized by the Board is not engaged at all, let alone "principally," in the securities underwriting activities described in section 20 of the Glass-Steagall Act. The Board's regulations expressly prohibit a bank holding company from "engag[ing], directly or indirectly, in the sale or distribution of securities of any investment company for which it acts as investment adviser." 12

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[24] 75 Cong. Rec. 9909 (1932) (discussion by Senator Bulkley of section 18 of S.4412, 72d Cong., 1st Sess. (1932), which was the predecessor of section 20 of the Glass-Steagall Act).

[25] Mr. Justice Douglas, who wrote the opinion of the Court in *Agnew*, had been Chairman of the SEC at the time of the SEC study that culminated in the *Investment Company Report*.

C.F.R. § 225.125(h). The task of underwriting, distributing, and maintaining a market for the investment company's shares is therefore left to "an independent underwriting firm" that performs these functions under contract. Pet. App. D, pp. 56a-57a. The bank holding company plays no role in "the issue, flotation, underwriting, public sale, or distribution" of any securities.

In addition, the investment adviser to a closed-end investment company is insulated from the "promotional and other pressures incidental to the operation of an investment fund . . ." found to exist in *Investment Company Institute* v. *Camp*, 401 U.S. at 637.[26] As the Board has explained,

> in the case of a closed-end fund, there are no such promotional pressures on the adviser because the fund's growth results principally from increase in asset value, rather than from external growth. Therefore, the adviser's economic incentive to increase its compensation is accomplished by furnishing superior investment advice, rather than engaging in sales activities.

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[26] Respondent's counsel conceded in hearings before the Board that the organization and management of a closed-end investment company would not entail a serious risk of conflict of interest arising from promotional activities:

> In our judgment, the most serious of those conflicts of interest relate to this promotional aspect, this concern by the bank or its affiliates in constantly selling the shares, and that, as I say, is not typical of a closed-end company. So, I would have to be frank to say to you that the serious conflicts that we see are not present with respect to closed-end companies.

Transcript of Hearing before the Board of Governors of the Federal Reserve System on Bank Holding Companies to Serve as Investment Advisers to Investment Companies 15 (Nov. 12, 1971) (remarks of G. Duane Vieth).

Pet. App. D, p. 58a. The Board, moreover, has prohibited bank holding companies and their subsidiaries from engaging in promotional activity:

> Prospectuses or sales literature should not be distributed by the holding company, nor should any literature be made available to the public at any offices of the holding company. In addition, officers and employees of bank subsidiaries should be instructed not to express any opinion with respect to advisability of purchase of securities of any investment company for which the bank holding company acts as investment adviser. Customers of banks in a bank holding company system who request information on an unsolicited basis regarding any investment company for which the bank holding company acts as investment adviser, may be furnished the name and address of the fund and its underwriter or distributing company, but the names of bank customers should not be furnished by the bank holding company to the fund or its distributor.

12 C.F.R. § 225.125(h). As a consequence of these restrictions, a bank holding company that serves as an investment adviser will stand completely apart from the process of underwriting and distributing shares. That is all (indeed, more than) section 20 of the Glass-Steagall Act requires.

Even if the Board had not imposed these restrictions, the holding company's service as an investment adviser to a closed-end investment company still would not violate section 20. Serving as an investment adviser entails no activities beyond those permitted to the investment company itself, and a closed-end investment company of the type described in the Board's interpretive ruling does not engage "principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 20.

C. *Under The Board's Interpretive Ruling, A Bank Holding Company May Organize, Sponsor, Manage, And Control Only Investment Companies That Are Not Engaged Principally In The Activities Described In Section 20 Of The Glass-Steagall Act*

The Board's regulations permit bank holding companies to organize, sponsor, manage, and control only closed-end investment companies registered under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1, *et seq.* Such companies are not principally engaged in the securities underwriting activities described in section 20 of the Glass-Steagall Act.[27]

As a matter of law, registered investment companies may not engage principally in underwriting and distributing the securities of other issuers. Section 3(c)(2) of the Investment Company Act, 15 U.S.C. § 20a-3 (c)(2), excludes from the definition of "investment company" any firm that is "primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as a broker, or any one or more of such activities . . . ."[28] *And see Board of Governors* v. *Agnew*, 329 U.S. at 446 (a firm cannot be engaged "principally" in an activity in which it is not even "primarily" engaged).

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[27] Whether a closed-end investment company advised by a bank holding company is an "affiliate" for the purposes of section 20 is a question of mixed law and fact that could only be decided on a case-by-case basis. For purposes of the discussion here, however, we assume *arguendo* that such a closed-end investment company would be an affiliate subject to the strictures of section 20.

[28] An entity excluded from the statutory definition of "investment company" may not elect to be treated as such a company for purposes of the Investment Company Act. *See* 1 T. Frankel, *supra* n.3, at 354.

In addition, closed-end investment companies are not engaged principally in issuing or distributing their own shares:[29] "a closed-end investment company typically does not issue shares after its initial organization except at infrequent intervals and does not stand ready to redeem its shares." 12 C.F.R. § 225.125(c). A closed-end investment company is, therefore, no more engaged in the issue or distribution of securities than is any other business corporation:

> Since a closed-end company is under no obligation to redeem, that is, buy back its own shares, its capital structure is much like that of companies in other areas of the economy. Equity capital contributed by the public is viewed as permanently committed to the enterprise . . . . The company is not engaged in a continuous quest for new capital.

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[29] There is of course a significant difference between the securities underwriting activity addressed by section 20 and the occasional issuance by a corporation of its own shares: the former activity is a source of income, the latter only a source of capital. Securities underwriting firms derive their income through the success of their promotions; the earnings generated by an underwriting depend upon the number of the issuer's securities that the underwriter succeeds in selling and the spread between the price that the underwriter pays the issuer and the amount that it receives for the securities that it sells. *See generally United States* v. *Morgan*, 118 F.Supp. 621, 650-55 (S.D.N.Y. 1953). In contrast, a business corporation issues its own securities simply to attract additional capital to the enterprise. The corporation's income is generated through the use of that capital and not by the process of raising it. In particular, the earnings of a closed-end investment company derive solely from the capital appreciation, dividends, and interest produced by its investments and not from promotional and sales activities. *See* SEC, *Report on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 2337, 89th Cong., 2d Sess. 43 (1966) (*"Public Policy Implications"*).

Public Policy Implications, *supra* n.29, at 42-43. Because a closed-end investment company is a basically static investment vehicle, it differs significantly from an open-end investment company, or "mutual fund," which "is continuously engaged in issuing its shares and stands ready at any time to redeem them." Pet. App. A, p. 6a.[30]

Closed-end investment companies, therefore, by their very nature are not "engaged principally" in the activities described in section 20 of the Glass-Steagall Act. But even if an occasional closed-end investment company, because of its aberrant mode of operation, arguably could be said to be "engaged principally" in those activities, *cf.* 12 C.F.R. § 218.104(d), the validity of the Board's regulation would not be affected. The Board's regulation is not self-executing. A bank holding company must apply individually for permission to serve as investment adviser to an investment company, and the Board determines on a case-by-case basis whether granting the application "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse affects . . . ." 12 U.S.C. § 1843(c)(8). *See, e.g.*, *Independent Bankers Ass'n of Georgia* v. *Board of Governors*, 516 F.2d 1206, 1215-16 (D.C. Cir. 1975). The Board can and should inquire, upon administrative consideration of specific applications, whether peculiar operating features of a particular closed-end investment company raise a question under section 20 of the Glass-Steagall Act. No such inquiry is presented by judicial review of the bare bones of the regulation.

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[30] For the same reason, closed-end investment companies also differ significantly from the bank-operated collective investment funds that this Court recognized to be essentially equivalent to mutual funds in *Investment Company Institute* v. *Camp*, 401 U.S. at 625.

The only question here is whether the activities authorized by the regulation on its face are consistent with the applicable statutes. The Board has eliminated any possibility of conflict between its regulation and the Glass-Steagall Act by providing that bank holding companies may sponsor, organize, manage, and control only those closed-end investment companies that "are not primarily or frequently engaged in the issuance, sale and distribution of securities." 12 C.F.R. § 225.125(f). This restriction is, as the Board noted, "consistent with—and even stricter than—the provision of section 20 of the Glass-Steagall Act which . . . prohibits affiliation with a member bank [only] where a company is 'engaged principally' in [the] securities activities [described therein]." Pet. App. E, p. 77a.

The Board's regulation would be valid even in the absence of this limitation. The circumstances surrounding the enactment of the Glass-Steagall Act and subsequent legislative developments demonstrate that Congress has consistently recognized and understood that the Act does not prohibit banks from affiliating with, or even sponsoring and managing, closed-end investment companies. At the time of the enactment of the Glass-Steagall Act, there were in operation well over 100 closed-end investment companies (or, as they were then commonly known, "investment trusts").[31] Twelve closed-end investment companies, with assets exceeding $70 million, were sponsored and managed by banks.[32] These

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[31] *See* H. Bullock, *The Story Of Investment Companies* 73 (1959); *Investment Company Report, supra* n.12, at 57, 124 (Table 25). During the 1920's and 1930's closed-end investment companies were far more common than open-end companies. *See, e.g., Public Policy Implications, supra* n.29, at 43-44.

[32] *Investment Company Report, supra* n.12, at 57, 124 (Table 25).

investment companies continued to be sponsored and managed by banks after passage of the Glass-Steagall Act, with no suggestion by Congress, the SEC, or anyone else that the continued affiliations might violate section 20.[33]

When Congress specifically turned its attention to investment companies only a few years later, it approved the continuation of existing affiliations between banks and closed-end investment companies.[34] Section 10(c) of the Investment Company Act of 1940, 54 Stat. 806, which prospectively barred a registered investment company from having "a majority of its board of directors consisting of persons who are officers or directors

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[33] *Id.* The court of appeals misread the *Investment Company Report* as providing "indirect evidence that at least the industry viewed the Glass-Steagall Act as broadly prohibiting such activity." Pet. App. A, p. 28a n.30. The court overlooked the fact that the *Report* showed banks had continued to sponsor closed-end investment companies after the enactment of the Glass-Steagall Act. *See Investment Company Report, supra* n.12, at 57 n.38, 59, 124 (Table 25). The court cited as "evidence" the fact that, following enactment of the Glass-Steagall Act, closed-end investment companies were no longer sponsored by "bank securities affiliates." The reason for this, however, is that the term "bank securities affiliates," as used in the *Report*, referred to a category of entities (*i.e.*, investment banking houses) affiliated with banks that had been legislated out of existence by the Glass-Steagall Act. *Id.* at 57 n.38.

[34] There were no bank-sponsored open-end investment companies in 1940. *In the Matter of First National City Bank*, ICA Rel. No. 4538, [1964-66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,332, at 82,589 (March 9, 1966), *aff'd sub nom. National Ass'n of Securities Dealers, Inc.* v. *SEC*, 420 F.2d 83 (D.C. Cir. 1969), *vacated sub nom. Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971).

of any one bank," contained a "grandfather clause" for existing majority interlocks:

> [I]f on March 15, 1940, any registered investment company shall have had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such registered company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

The purpose of this grandfather clause was to permit the existing bank-managed closed-end investment companies to continue in operation.[35] Congress would not have condoned the operation of these bank-managed companies, and certainly would not have enacted a grandfather clause approving their continued operation, if it had believed that such operation had been and would continue to be in violation of the Glass-Steagall Act or contrary to its "overarching policy."

Even apart from the grandfather clause, section 10(c) of the Investment Company Act demonstrates that closed-end investment companies are not "engaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of section 20 of the Glass-Steagall Act. At the time of the enactment of section 10(c), 15 U.S.C. § 80a-10(c), section 32 of the Glass-Steagall Act already prohibited

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[35] During its consideration of section 10(c), Congress was specifically advised by the SEC that banks were continuing to sponsor closed-end investment companies and that existing law allowed "an interlocking majority" of directors between banks and investment companies. The SEC recommended the use of a grandfather clause in order not to disrupt "the delicate relationship between banks and investment companies." *Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 885-86 (1940) ("*Hearings on S. 3580*").

any officer, director, or employee of a member bank from serving as an officer, director, or employee of a company "primarily engaged" in the securities activities described in section 20.[36] But section 10(c) of the Investment Company Act *permits* minority interlocks between banks and investment companies and explicitly authorized the continuation of then-existing majority interlocks. If closed-end investment companies were even "primarily engaged" (and *a fortiori* if they were "engaged principally") in the securities underwriting activities described in section 20 of the Glass-Steagall Act, then section 32 of that Act and section 10(c) of the Investment Company Act would always have been in conflict as to such companies. The legislative history of section 10(c), however, is devoid of evidence that Congress perceived such a conflict. Nor does it contain evidence that Congress viewed the existing interlocking relationships permitted by section 10(c) as having previously been unlawful. *See* n.35 *supra.*

The significance of section 10(c) of the Investment Company Act goes beyond merely demonstrating that Congress, in legislating with respect to investment companies in 1940, acted on the basis of its understanding that a closed-end investment company is neither "engaged principally" nor "primarily engaged" in the securities underwriting activities described in sections 20 and 32 of the Glass-Steagall Act. Section 10(c) is also an affirmative expression of congressional policy regarding the relationships between banks and investment com-

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[36] As originally enacted in 1933, section 32 had barred such interlocking relationships between member banks and companies "engaged primarily in the business of purchasing, selling, or negotiating securities." 48 Stat. 194. In 1935, section 32 was amended to conform its language to that of section 20. 49 Stat. 709. *See* H.R. Rep. No. 742, 74th Cong., 1st Sess. 17 (1935).

panies: section 10(c) plainly contemplates that banks themselves may and will participate in the management of investment companies.[37] It allows a bank to have its officers, directors, and employees serve on the board of directors of an investment company, provided only that they do not comprise a majority of the board. And it places no restrictions whatever on the extent to which the bank-affiliated directors may be involved in the management, control, supervision, and operation of the investment company. Thus, when Congress explicitly focused its attention on the subject, it determined that within the limits allowed by the prohibition against majority interlocks, banks could not only affiliate with, but also lawfully participate in the management of, closed-end investment companies.

II. The Board Properly Determined That Serving As An Investment Adviser To A Closed-End Investment Company Is Closely Related To Banking Within The Meaning Of Section 4(c)(8) Of The Bank Holding Company Act

A. *The Board Has Broad Authority To Determine The Nonbanking Activities In Which Bank Holding Companies May Engage*

Section 4 of the Bank Holding Company Act of 1956, *as amended*, 12 U.S.C. § 1843, represents the principal legislative effort to define the activities in which bank holding companies may lawfully engage. It expresses Congress' judgment that although the business of bank holding companies properly centers upon banking, such companies may also engage in a variety of non-banking

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[37] Section 10(c) represented "a middle-road between no regulation and complete segregation" of banks from the management of investment companies. *Hearings on S. 3580, supra* n.35, at 217.

activities. In section 4, Congress employed the familiar device of a broad prohibition followed by specific exceptions. Section 4(a) by its terms purports to bar bank holding companies from engaging in any activities other than banking, but section 4(c) lists several exceptions to that general prohibition. For example, bank holding companies are authorized, as banks are not, to purchase securities—including shares of registered investment companies—for their own accounts. Sections 4(c)(6) and (7) of the Act, 12 U.S.C. §§ 1843(c)(6) and (7).

Congress recognized that a list of specific exceptions would not do full justice to the complexity of the industry it was seeking to regulate. Congress also understood that it lacked sufficient information and expertise to determine the full range of nonbanking activities that may be closely related to banking and therefore appropriate for a bank holding company:

> [C]ertain activities of a financial, fiduciary, or insurance nature are obviously so closely related to banking as to require no divestment by a bank holding company. . . . However, there are many other activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

S. Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955). Consequently, Congress chose to delegate to the Board responsibility for determining the extent to which bank holding companies would be permitted to engage in nonbanking activities other than those specifically identified in section 4(c).

Section 4(c)(8) grants this authority to the Board in sweeping terms. It provides that the general prohibition contained in section 4(a) "shall not apply to . . . activities . . . which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." This statutory language makes clear that the Board has been granted broad power to designate, in the exercise of its informed discretion, the nonbanking activities in which bank holding companies may engage. The standard to be applied by the Board is that the activity in question must be "so closely related to banking . . . as to be a proper incident thereto." Congress left to the Board the responsibility for determining, on the basis of the Board's expertise and familiarity with the banking industry, the proper content of the statutory standard.

Congress thus delegated to the Board with an open hand, relying upon the Board's superior fact-finding ability and expertise in banking matters for a discriminating evaluation of the extent to which bank holding companies should be permitted to engage in nonbanking activities. In doing so, Congress did not place any special limitation on the Board's power to authorize bank holding companies to engage in securities-related activities that are also "closely related to banking." In particular, Congress did not seek to bar the Board from permitting bank holding companies to serve as investment advisers to closed-end investment companies; rather, Congress left this issue, like many others, for resolution by the Board.

Congress did not contract the scope of the Board's authority when it amended the Bank Holding Company Act in 1970.[38] To be sure, efforts were made to add a "laun-

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[38] If anything, the 1970 amendments enlarged the Board's authority. In those amendments, Congress substituted the word "banking" for the phrase "business of banking" in

dry list" of limitations on the Board's authority, including a provision that would have barred the Board from permitting bank holding companies to engage *at all* in securities activities of the type described in section 20 of the Glass-Steagall Act.[39] The conference committee deleted this laundry list in its entirety, however, thereby leaving the Board's authority unchanged with respect to securities activities as well as other activities.[40]

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section 4(c)(8) in order to make clear that the Board may permit a bank holding company to engage in nonbanking activities whether or not those activities relate to the operations of the holding company's banking subsidiaries. H.R. Rep. No. 1747, 91st Cong., 2d Sess. 15-16 (1970) (Statement of House Managers).

[39] *See* H.R. 6778, 91st Cong., 1st Sess. § 1(f), 115 Cong. Rec. 33154 (1969); 115 Cong. Rec. 32897, 32902-03, 33133-34 (1969).

[40] In a colloquy on the Senate floor, Senator Sparkman, Chairman of the Committee on Banking and Currency, emphasized that the action of the Conference Committee, and the language of the bill as reported from the conference, simply left standing the existing provisions of the Glass-Steagall Act:

> As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. *There are some specific exceptions,* of course, but I can assure you that *we did not mean to enlarge or contract them here* . . . . In short, we did not intend to amend or modify, directly or indirectly any limitations on the activities of banks, bank-holding companies or any of their affiliates, now contained in the Glass-Steagall Act.

116 Cong. Rec. 42430 (1970) (emphasis added).

B. *In Determining That Bank Holding Companies May Serve As Investment Advisers To Closed-End Investment Companies, The Board Acted Well Within The Statutory Constraints On Its Authority*

The Board's authority under section 4(c)(8) is subject only to two relevant statutory constraints. First, the Board's factual determination of what activities are "so closely related to banking . . . as to be closely related thereto" is solely within the province of the Board, subject only to judicial review to protect against arbitrary or capricious administrative action. 5 U.S.C. § 706. This constraint is not pertinent here. The Board's determination that serving as an investment adviser to a closed-end investment company is "so closely related to banking" was factually correct, pp. 9-11 *supra*, and respondent has not suggested that the Board acted arbitrarily or capriciously.[41] The court of appeals was not confronted with that issue, and it is not before this Court.

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[41] In adopting the regulation, the Board carefully and extensively considered all relevant factual and legal issues. The Board heard oral testimony during two days of hearings and received written comments from a variety of interested persons. Following its review of the comments received and the record of the hearing, the Board not only promulgated the regulation initially proposed, in an amended form, but also issued an interpretive ruling that painstakingly protected against potential abuses and hazards that had been identified. Subsequently, the Board twice responded, thoughtfully and in detail, to respondent's objections. This therefore is not a case where the agency "adopted no expressly articulated position at the administrative level . . . [or] promulgated [its regulation] without opinion or accompanying statement." *Investment Company Institute* v. *Camp*, 401 U.S. at 627. To the contrary, the Board's decision was thoroughly reasoned and fully explained.

Second, the Board's authority is constrained by the terms of the Glass-Steagall Act. Section 4(c)(8) of the Bank Holding Company Act empowers the Board to exempt activities only from the prohibition of section 4(a), not from statutory prohibitions expressed elsewhere; thus, the Board may not permit bank holding companies to engage in activities that are expressly forbidden to them by the Glass-Steagall Act. *See* 12 C.F.R. § 225.125 (b).[42] The only section of that Act which limits the business activities open to bank holding companies is section 20, and the Board's regulations do not authorize bank holding companies to engage in activities that would violate that provision. *See* pp. 14-17 *supra*.

The opinion below suggests, although without squarely holding, that the Board's authority is subject to a third, implicit, statutory constraint derived from former section 19(e) of the Glass-Steagall Act, 48 Stat. 188. Section 19(e) had been repealed more than five years before the Board adopted its regulation. 80 Stat. 242-43 (1966). The court of appeals appeared to reason, however, that in enacting the Bank Holding Company Act in 1956 Congress, with section 19(e) in mind, had intended to place a continuing nontextual limitation on the Board's authority under section 4(c)(8).

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[42] In this Court, respondent argued for the first time that the Board may not permit bank holding companies to engage in activities that are forbidden to *banks* by the Glass-Steagall Act. *See* Br. in Opp. 7-8, 15-16. But the very purpose of section 4(c)(8) is to empower the Board to authorize holding companies to engage in activities that are not permitted to banks under section 4(a). *See* p. 6 n.10 *supra*. This relationship is confirmed by section 4(a)(2), which provides that bank holding companies may engage in "(A) . . . banking . . . *and* (B) those [activities] permitted under [section 4(c)(8)]" (emphasis added).

There is no support for the theory that Congress intended to place any nontextual limitation on the Board's authority under section 4(c)(8) of the Bank Holding Company Act, let alone a limitation derived from section 19(e) of the Glass-Steagall Act. The best guide to the intention of Congress in enacting the Bank Holding Company Act is the language that Congress used. That language broadly empowers the Board to authorize bank holding companies to engage in activities that it determines to be closely related to banking. It does not require the Board to treat activities involving securities differently from other activities. The court of appeals was unable to point to evidence in the legislative history that is incompatible with the undifferentiated authority conferred by the language of section 4(c)(8). To the contrary, the court of appeals conceded that "the legislative history provides virtually no guidance" beyond the broad language that Congress used in delegating authority to the Board. Pet. App. A, p. 30a.

Nor does the history or content of section 19(e) of the Glass-Steagall Act support the suggestion that there existed an implied, nontextual limitation on the Board's authority. Section 19(e) was only a part (and a minor part at that) of a broader set of provisions in section 19, which required a bank holding company to meet certain conditions as a prerequisite to voting the shares of its banking subsidiaries. Section 19 "authorized the Board to regulate the financial and managerial soundness of bank holding companies and their banking subsidiaries." *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243 (1978). But because section 19 prescribed only a voting-permit procedure, and did not directly regulate or limit the activities of the holding company, it "ultimately proved of little value." *Id.* at 244. "[I]n 1966 Congress repealed [these] voting permit provisions . . . because it believed that the Board retained authority

under § 3(c) [of the Bank Holding Company Act] to ensure the financial and managerial soundness of holding companies and their subsidiary banks." 439 U.S. at 246.[43]

Thus, section 19 of the Glass-Steagall Act, even taken as a whole, played but a brief and ineffectual role in the regulatory scheme. By no stretch of the imagination can section 19 be viewed as affording special guidance to a determination of the extent of the Board's authority under section 4(c)(8) of the Bank Holding Company Act.

Moreover, section 19(e) itself simply barred a bank holding company from voting the shares of its banking subsidiary if the holding company also held an interest in a company "principally" engaged in the same activities that were described in section 20. Because the activities in which bank holding companies are permitted to engage by the Board's regulation do not trigger the prohibition of section 20, they would not have triggered the voting permit limitation of section 19(e).[44]

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[43] The court of appeals mistakenly asserted that "[t]he Senate Report, commenting on the repeal, noted that section 19(e) *'serve[d] no substantial purpose'* after passage of the 1956 Act." Pet. App. A, p. 32a (emphasis added by court of appeals; footnote omitted). In fact, the Senate Report did not cite section 19(e) or refer in any way to the securities activities described therein. The only reasons the Report gave for the repeal applied to section 19 as a whole, and those are the reasons discussed by this Court in *First Lincolnwood*. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. (1966).

[44] The court of appeals appears to have believed that Congress employed the voting-permit procedure of section 19(e), and possibly also the "engaged principally" standard of sections 19(e) and 20, out of concern that the congressional power under the commerce clause did not allow more intensive federal regulation of state-chartered companies. Pet.

The court of appeals' approach has made a simple case complicated. That approach and the result to which it led are wrong. The plain language of section 4(c)(8) authorizes the Board to do what it did. Nothing in the legislative history of section 4(c)(8) imposes a non-textual constraint on the Board's power to authorize bank holding companies to engage in otherwise lawful securities-related activities. And the activities authorized by the Board's regulation are otherwise lawful, for nothing in the text or the policy of the Glass-Steagall Act prohibits bank holding companies from organizing and managing closed-end investment companies in the manner authorized by the Board's regulation.

App. A, pp. 25a-28a. Whether or not Congress was influenced by that consideration is immaterial. What is of paramount significance is that Congress drew the lines that it did. The fact is that section 19 was only a voting permit procedure; it may not now be judicially resurrected as an outright prohibition against the activities described therein. Nor may the distinction marked by the "engaged principally" standard of both section 19(e) and section 20 be obliterated. *Board of Governors* v. *Agnew*, 329 U.S. at 447-48.

CONCLUSION

The judgment of the court of appeals should be reversed.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF RESPONDENT

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OCTOBER TERM, 1979

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INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF RESPONDENT

The Securities Industry Association, with the consent of the parties, submits this brief, *amicus curiae,* in support of affirmance of the decision of the court of appeals below.

INTEREST OF THE *AMICUS CURIAE*

The Securities Industry Association ("SIA") is a national trade association representing approximately 500 organizations responsible for over 90 percent of the securities brokerage and investment banking business of the nation. Its membership is a cross-section of the diverse facets of the securities business and encompasses members of the national securities exchanges, as well as firms which are not members of such exchanges. The business of its members includes retail and institutional brokerage, over-the-counter market-making, underwriting and other invest-

ment banking activities. Many SIA members sponsor open- and closed-end investment companies, which permit the investing public to pool investment capital and obtain the advantages of a broader portfolio of investments than otherwise would be available to most individual investors.

The SIA and its members have a clear interest in whether this Court determines to sanction the continuing efforts of the banking industry to expand into the securities business. Such expansion, at the securities industry's expense, would not produce healthy competition because it would be based on inherent advantages, enumerated below, which make any competition between bank holding companies and members of the securities industry unequal and unfair. Moreover, if bank holding companies are to engage in the securities business, as the ruling of the Board of Governors of the Federal Reserve System ("Board") would permit and encourage, the result will be their domination of the capital markets and resultant distortion of our economy's capital-raising mechanism.

SUMMARY OF ARGUMENT

I

Investment Company Institute v. *Camp* held that Sections 16 and 21 of the Glass-Steagall Act prohibit a commercial bank from operating an investment fund which, in that case, was comparable to an open-end investment company. All of the investment companies operated by banks and bank affiliates during the period which preceded enactment of the Glass-Steagall Act, however, were of the closed-end variety. Thus, there is no plausible reason why Congress would have intended to limit the reach of the Act to open-end companies. The distinction drawn by the Board between the operation of open- and closed-end investment companies is not meaningful, either in terms of the hazards Congress sought in the Glass-Steagall Act to eliminate or the language of Sections 16 and 21. Similarly, there is no rational basis for the Board's contention that Congress

wished to permit banks to do indirectly, through affiliates, what they could not do directly. Thus Sections 16 and 21, as interpreted in *Camp,* must be read to prohibit banks and bank affiliates from operating closed- as well as open-end investment companies.

II

The regulation at issue was promulgated under Section 4(c)(8) of the Bank Holding Company Act, and its legality therefore must be measured by whether the activity it sanctions is "so closely related to banking . . . as to be a proper incident thereto." Although banks traditionally have managed common trust funds, there is a fundamental distinction between the sale of fiduciary services and the sale of investments. Operating investment companies is not a traditional bank activity. The Board itself has recognized that activities unlawful for banks may not be "closely related" or a "proper incident" to banking, and, as we will show, operation of a closed-end fund by a bank itself is unlawful under the Glass-Steagall Act. The legislative history of the 1970 amendments to the Bank Holding Company Act, which focused specifically on the "closely related" standard, confirm that that Act was not intended in any way to permit bank holding companies to engage in securities activities prohibited to banks.

III

The Board's reliance upon Section 20 of the Glass-Steagall Act is misplaced. *Camp* makes clear that, with respect to the operation of investment companies, Congress did not wish to permit banks to do indirectly, though affiliates, what they could not do directly. Since Congress intended to prohibit banks from operating closed- as well as open-end investment companies, Section 20 of the Glass-Steagall Act logically must be read to prohibit bank affiliates from operating closed- as well as open-end investment companies. Alternatively, it is a reasonable interpretation of that Section that it does not apply at all to bank holding company affiliates, the scope of whose non-banking activi-

ties is regulated by the Bank Holding Company Act. This interpretation is based on the premise that when Congress broadened the definition of "affiliate" in the Glass-Steagall Act in 1966 to include bank holding companies, it did so only for purposes of the Federal Reserve Act and not for purposes of the Glass-Steagall Act. Even if Section 20 does apply to bank holding companies, however, it is not an authorizing provision but a prohibitory one. Thus, an activity it fails to prohibit does not *ipso facto* meet the Section 4(c)(8) standard; it must satisfy that test independently, and operation of a closed-end fund cannot do so.

IV

The Court need not pay deference to the Board's interpretation of the applicable statutes in this case. Where, as here, the question before the Court is purely one of law or statutory construction, the expertise of the agency is not a ground for according it deference. The principle of judicial deference cannot override a court's general duty to interpret and apply the law as the court perceives it. In this area in particular, the Board's claim to deference is diminished by the frequency with which courts have found it necessary to circumscribe permissive rulings by federal bank regulators allowing bank expansion into non-banking activities. Moreover, the implications of the Board's ruling are so sweeping that they should be effected only by an unambiguous legislative mandate.

ARGUMENT

I. Sections 16 and 21 of the Glass-Steagall Act Prohibit the Operation by Banks of Closed-End Investment Companies

In *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), this Court held that Sections 16 and 21 of the Glass-Steagall Act[1] 12 U.S.C. §§ 24 Seventh and 378 pro-

[1] The Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162, contains a number of provisions collectively known as the Glass-Steagall Act, which are presently codified at various places in Title 12 of the United States Code.

hibit banks from operating open-end investment companies. In that decision, the Court in no way limited the import of its holding to the operation of open- rather than closed-end companies. On the contrary, the Court framed the issue before it as whether the Comptroller of the Currency could "authorize a national bank to offer its customers the opportunity to invest in a *stock fund created and maintained by the bank.*" 401 U.S. at 621 (emphasis supplied). As shown below, there is no meaningful distinction between the operation of open- and closed-end investment companies in terms of the hazards Congress sought in the Glass-Steagall Act to eliminate. Moreover, the language of Sections 16 and 21, as interpreted in *Camp,* is as equally applicable to bank operation of a closed-end as it is an open-end investment company.

A. There is no meaningful distinction between the operation of open- and closed-end investment companies in terms of the hazards Congress sought to eliminate.

This Court determined in *Camp* that Sections 16 and 21 of the Glass-Steagall Act do not permit the Comptroller to "authorize a national bank to offer its customers the opportunity to invest in a stock fund created or maintained by the bank." *See* 401 U.S. at 621, 639. In *Camp* the Comptroller had argued that these Sections were intended to prohibit only the abuses which had occurred when banks or their security affiliates had invested bank assets in speculative securities or had engaged in underwriting original issues "for the traditional and direct form of distribution profit." *National Association of Securities Dealers, Inc.* v. *Securities and Exchange Commission,* 420 F.2d 83, 89-90 (D.C. Cir. 1969), *rev'd in part and vacated in part,* 401 U.S. 617 (1971). In rejecting that limited view of the intended reach of the Glass-Steagall Act, this Court pointed out that Congress "had in mind and repeatedly focused on the more subtle hazards" which arise when a commercial bank or its affiliate sponsors and controls an investment company which

obtains money from the general public to speculate in securities. 401 U.S. at 630.[2]

As shown in *Camp*, one of the specific concerns of Congress was the hazards to the soundness of the banking system which arise when bank security affiliates obtain funds from the general public, not for fiduciary purposes, but rather for the operation of an investment trust:

> The Glass-Steagall Act was the product of hearings conducted pursuant to Senate Resolution 71 which included among the topics to be investigated the impact on the banking system of the formation of investment and security trusts. The subcommittee found that one of the activities in which bank security affiliates engaged was that of an investment trust: "buying and selling securities acquired purely for investment or speculative purposes." Since Congress generally intended to divorce commercial banking from the kinds of activities in which bank security affiliates engaged, there is reason to believe that Congress explicitly intended to prohibit a national bank from operating an investment trust.

401 U.S. at 635 (footnotes omitted).

This Court observed in *Camp* that the operator of an investment fund "would necessarily put its reputation and facilities squarely behind that fund and the investment

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[2] Among the principal "more subtle" hazards identified by this Court in *Camp* were (A) impairment of public confidence in the bank if the securities affiliate fares badly since the bank and the affiliate become closely associated in the public mind; (B) pressure on the bank to make its credit facilities and possibly even unsound loans more readily available to companies in whose securities the affiliate has invested or otherwise becomes involved; (C) the possible risk that bank depositors would suffer losses on the investments they purchased in reliance on the relationship between the bank and its securities affiliate; (D) the danger that the bank would be tempted to make customer loans more liberally for purposes of facilitating the purchase of its affiliates' securities; and (E) conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice. 401 U.S. at 630-34.

opportunity that fund offered," and poor performance of the fund "could bring about a perhaps unjustified loss of public confidence" in the sponsoring bank. 401 U.S. at 637. Both open- and closed-end investment funds are formed for the purpose of " 'buying and selling securities acquired purely for investment or speculative purposes,' " *see* 401 U.S. at 635 (footnote omitted), and the fact that a closed-end fund does not stand ready to redeem and sell its shares at net asset value, and thus typically sells its stock to the public less frequently that an open-end fund, does not materially reduce the risks inherent in the fund's operation or the loss of public confidence that would attend its failure. As the Court stated in *Camp*:

> If the fund investment should turn out badly, there would be a danger that the bank would lose the good will of those customers who had invested in the fund. It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank. But because banks are dependent on the confidence of their customers, the risk would not be unreal.

401 U.S. at 638.

The Federal Reserve Board has sought to obviate this danger through its regulation prohibiting closed-end investment companies from using names similar to those of the sponsoring bank, 12 C.F.R. § 225.125(f) (1980), but it does not otherwise bar association of the sponsor's name with the fund. It therefore can be expected that banks will make every effort to ensure public awareness of the identity of the sponsoring bank. This was the experience in the case of the 1979 creation of the Chancellor High Yield Fund, Inc., where Citibank, N.A. acted as investment adviser to the fund. It was abundantly clear from the fund's initial press release and other promotional materials that the parties fully intended to make extensive use of Citibank's banking prestige and name in marketing the fund to the public. *See* Petition of Investment Company Institute for the Institution of Cease and Desist Proceedings Against Citibank, N.A., Before The Comptroller of the Currency (filed August 14, 1979).

Another potential hazard is the temptation for a bank imprudently to extend credit to those companies in which the fund has invested to prevent a failure or decrease in the value of the investment fund.[3] *Hearings Pursuant to S. Res. 71 Before a Subcommittee of the Senate Committee on Banking and Currency,* 71st Cong., 3d Sess. 1064 (1931). *See also* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). The bank's function as a disinterested and impartial allocator of credit is impaired by virtue of its association with the fund. In other words, "[t]he bank's stake in the investment fund might distort its credit decisions or lead to unsound loans to the companies in which the fund had invested." 401 U.S. at 637. Once again it is difficult to see any way in which a bank's "stake" in its fund is at all diminished merely because the fund's shares are not redeemable.

An additional congressional concern was the potential for conflict "between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice." 401 U.S. at 633. This conflict arises simply because the bank, whose fee typically is based on the amount of assets under its management, has an economic interest in accumulating funds for the investment company. Although the regulations of the Federal Reserve Board seek to avoid this conflict by prohibiting bank holding companies from soliciting the bank's customers for shares in the investment company itself, 12 C.F.R. § 225.125(h) (1980), the bank may be tempted to abuse its fiduciary duty by investing funds it holds in trust in the same securities held in the investment company's portfolio. This allows the bank to support the investment company's asset value to the possible detriment

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[3] An excellent illustration of this temptation is the experience in the early 1970s with bank-sponsored real estate investment trusts ("REITs"). The poor performance or failure of many projects in which REITs invested prompted their bank sponsors to extend numerous unsound loans to prevent the total collapse of the REITs.

of those for whom it acts as trustee. Once again, this danger is as real when a bank operates a closed-end as an open-end company.

Finally, there is the possibility that "the bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund." 401 U.S. at 637-38. Banks have the opportunity to tie the granting of credit to their securities services and otherwise to use their lending relationship to gain additional business. The tie-ins which may occur when banks are involved in the marketing of securities services derive from the ability of commercial banks to extend credit. It is not so difficult to perceive how a creditor of a bank might think it consistent with maintaining "good banking relations" to appear on the list of holders of shares in the bank's investment company. The danger of such implicit tie-ins was discussed by Richard W. McLaren, then Assistant Attorney General in charge of the Antitrust Division, in testimony before the Senate Banking and Currency Committee when it was considering the 1970 one-bank holding company legislation:

> [T]here are dangers which are more of a structural nature—adverse competitive effects that would tend to develop naturally without actual overt use of the economic power carried over from the banking sphere.
>
> I refer to a voluntary form of reciprocity or tie-in effect, where a potential borrower may independently decide that, just because he might possibly be under watch, it is in his best interest to patronize bank-affiliated enterprises in the hope of improving his chances of obtaining credit from the bank on favorable terms, or indeed at all.

Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess. 239-40 (1970). *See also Hearings on H.R. 6778 Before the House Committee on Banking and Currency,* 91st Cong., 1st Sess. 91-92 (1969). Again, the likelihood of this situation arising is not at all dependent on whether or not the shares of the investment fund are redeemable.

There is no conceivable reason why Congress would have intended to limit the reach of the Glass-Steagall Act to the operation of an open- but not a closed-end investment company. During the period which led to the banking crisis that precipitated passage of the Glass-Steagall Act, substantially all of the investment companies in operation were of the closed-end rather than the open-end variety. *See Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 124 (Table 25) (1939). In 1929 not one open-end investment company was sponsored by a commercial bank or bank affiliate. Every investment company sponsored by a commercial bank or its security affiliate, including those whose abuses filled the pages of the SEC study, was closed-end. *Id.* To suggest, as does the Board, that Congress intended to prohibit banks or bank affiliates from sponsoring and controlling only open-end investment companies in effect says that Congress diagnosed the banking industry as having an abscessed tooth but then went ahead and pulled only the tooth next to it.

B. As interpreted by the Court in *Camp*, the terms of the Glass-Steagall Act prohibit banks from operating both closed- and open-end investment companies.

Section 16 of the Glass-Steagall Act provides:[4]

> The business of dealing in securities and stock by [any national or state member bank in the Federal Reserve System] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [member bank] shall not underwrite any issue of securities or stock. . . .

By its terms, the section strictly limits a bank's ability to deal in securities. If it does so, it may purchase and sell securities "solely upon the order, and for the account of,

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[4] The provisions of Section 16 are also made applicable to state member banks by Section 5(c) Fifth of the Glass-Steagall Act, 12 U.S.C. § 335.

customers." This limitation requires that the transaction be initiated by the customer. Even assuming *arguendo* that an investment fund created by a bank can be a "customer"—a definition plainly at odds with the import of the statute—virtually all transactions effected by a bank for a fund it operates would be initiated by the bank, not the "customer." [5] Thus, a bank's operation of any investment fund, whether open- or closed-end, would transgress the limits of Section 16.

Section 21 of Glass-Steagall provides:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits. . . .

Section 21 thus forces every financial institution to make a choice. It may either engage in commercial banking or it may engage in the securities business; it may not do both.

The Court summed it up in *Camp* as follows:

> One would suppose that the business of a mutual fund consists of buying stock "for its own account" and of "issuing" and "selling" "stock" or "other securities" evidencing an undivided and redeemable interest in the assets of the fund. On their face, §§ 16 and 21 of the Glass-Steagall Act appear clearly to prohibit this activity by national banks.

401 U.S. at 625 (footnotes omitted). Although the Court made specific reference to a mutual fund, a closed-end fund engages in identical activity, albeit with less frequency.

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[5] A bank necessarily initiates transactions in securities for funds in respect of which it acts as trustee. It does so, however, pursuant to the trust powers granted it under authority of Section 11 of the Federal Reserve Act, Pub. L. No. 43, 38 Stat. 261 (1913), as implemented by Regulation F of the Federal Reserve Board, 12 C.F.R. Part 206 (1980).

But for purposes of these provisions, and particularly Section 21, frequency is irrelevant since the prohibition is unqualified.

In sum, for purposes of the Glass-Steagall Act, the distinction drawn by the Board between open- and closed-end funds is immaterial; the Act must be read to prohibit both. Any other reading of those provisions, or of the Court's decision in *Camp*, would constitute a wholly unwarranted exaltation of form over substance.

II. Section 4(c)(8) of the Bank Holding Company Act Does Not Permit Bank Holding Companies To Operate Closed-end Investment Companies

The regulation of the Board permitting operation by bank holding companies of closed-end investment funds was promulgated under Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. § 1843(c)(8).[6] As the Board points out, Pet. Br. 19, an analysis of the requirements of any statute "must begin with the language of the statute itself." *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979). *Accord, Transamerica Mortgage Advisers, Inc.* v. *Lewis*, —— U.S. ——, 100 S. Ct. 242 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). But the Board looks to the wrong statute. An analysis of the prohibitions of Section 4(c)(8) of the Bank Holding Company Act must start not with Section 20 of the Glass-Steagall Act but with Section 4(c)(8) itself.

Section 4(c)(8) provides an exception to the general prohibitory language of Section 4(a) of the Bank Holding Company Act[7] "to permit the retention by a bank

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[6] The Bank Holding Company Act, Pub. L. No. 511, 70 Stat. 133 (1956), is codified at 12 U.S.C. §§ 1841 *et seq.*

[7] Section 4(a)(2) of the Act, 12 U.S.C. § 1843(a)(2), provides that:

> [N]o bank holding company shall . . . engage in any activities other than (A) those of banking or of managing or controlling

holding company of activities found to be closely related to *banking.*" S.Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955) (emphasis supplied). It does not permit bank holding companies to engage in nonbanking activities—whether securities-related or not—if they merely refrain from doing so "principally." Moreover, the legislative history of this provision, *see infra,* pp. 17-21, leaves no doubt that Congress intended the proper incidents of banking to be defined in part by the prohibitions contained in the Glass-Steagall Act with respect to the activities of banks themselves.

As demonstrated in Part I, the operation by banks of closed-end investment companies is prohibited by Sections 16 and 21 of the Glass-Steagall Act. It is illogical to contend, as does the Board, that Congress intended to permit banks to engage indirectly, through the "back door" of their holding companies, in activities foreclosed to them directly: activity prohibited to banks simply cannot be "closely related" or a "proper incident" to banking. Thus the Board was without authority to conclude that the activity at issue is permissible for bank holding companies.

A. Under Section 4(c)(8), the operation of a closed-end investment company is not an activity "so closely related to banking . . . as to be a proper incident thereto."

The Board asserts that the operation of a closed-end investment company is "closely related" to banking because "banks generally engage in that activity or . . . in activities that are similar." Pet. Br. 54. In an attempt to prove that the operation of closed-end investment companies meets

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banks . . . and (B) those permitted under paragraph (8) of subsection (c). . . .

Section 4(c)(8), 12 U.S.C. § 1843(c)(8), provides an exception for:

> shares of any company the activities of which the Board . . . has determined . . . to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

this test, the Board points to the "conventional fiduciary services" traditionally engaged in by bank trust departments in organizing and managing "large collective investment funds such as common trust funds and pooled employee benefit funds." Pet. Br. 55. It is true that these are traditional and proper activities for banks acting in their fiduciary capacity on behalf of customers. But from this, the Board leaps to the conclusion that "it is evident that managing a closed-end investment company is 'closely related' to such traditional services." *Id.* In so doing, the Board ignores this Court's teaching in *Camp* and overlooks the fundamental distinction between the sale of fiduciary services and the sale of investments.

In *Camp,* this Court detailed the hazards that arise when a commercial bank goes beyond the business of acting as a fiduciary or managing agent and engages in the securities investment business. *See* 401 U.S. at 630. The Court emphasized that:

> These are all hazards that are not present when a bank undertakes to purchase stock for the account of its individual customers or to commingle assets which it has received for a true fiduciary purpose rather than for investment. These activities, unlike the operation of an investment fund, do not give rise to a promotional or salesman's stake in a particular investment; they do not involve an enterprise in direct competition with aggressively promoted funds offered by other investment companies; they do not entail a threat to public confidence in the bank itself; and they do not impair the bank's ability to give disinterested service as a fiduciary or managing agent. In short, *there is a plain difference between the sale of fiduciary services and the sale of investments.*

401 U.S. at 638 (emphasis added).

The Board itself has long recognized this "plain difference." As the Court pointed out in *Camp,* 401 U.S. at 621:

> The Board of Governors of the Federal Reserve System, which until 1962 had regulatory jurisdiction over

> all the trust activities of national banks, allowed the collective investment of trust assets only for "the investment of funds held for true fiduciary purposes." The applicable regulation, Regulation F, specified that "the operation of such Common Trust Funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited." The Board consistently ruled that it was improper for a bank to use "a Common Trust Fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments." 26 Fed Reserve Bull. 393 (1940); *see also* 42 Fed Reserve Bull. 228 (1956); 41 Fed Reserve Bull. 142 (1955).

In asserting that the operation of closed-end investment companies is "closely related" to banking, then, the Board ignores not only this Court's crucial distinction in *Camp* between fiduciary and investment activity, but the policy of the Federal Reserve Board itself in its regulation of banks from 1913 to 1962.

The Board cites a Securities and Exchange Commission report of 1939 as indicating "that managing a closed-end investment company is 'closely related' to such traditional services" provided by banks. Pet. Br. 55. However, as the SEC report makes clear, with no ambiguity whatsoever, its study involved only the

> ". . . commingling of trust funds . . . into a common pool for more convenient and secure investment, *in which commingled fund there may be no other participants* . . ."[8]

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[8] *Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies), H.R. Doc. No. 476, 76th Cong., 2nd Sess. 3 n. 3 (1939), *quoting* McWhinney, *Results from Questionnaire on Commingling of Trust Funds*, 52 Trust Company Magazine 334 (1931) (emphasis supplied).

Thus, the report does not at all define the traditional role of a bank as including the management of a closed-end investment company. Rather, the scope of the report is explicitly limited to bank operation of common trust funds, and is not in any way concerned with the activity at issue here.

The Board also cites another report of the Securities and Exchange Commission,[9] which indicates that banks and trust companies sponsored twelve closed-end investment companies both before and after the passage of the Glass-Steagall Act, as supporting its contention that banks have traditionally engaged in the activities now sought to be permitted. Pet. Br. 55. But such an interpretation is unjustified. First, since the category explicitly includes trust companies, it is not clear from this information how many of these twelve investment companies were operated by commercial banks. SEC Report, *supra* note 9, at 124. Second, the report indicates that a bank may have been assumed to be the fund's "sponsor" simply because of difficulties in identifying the true sponsor or organizer. *Id.* at 56. The report, then, is highly ambiguous and vague in its use of terminology. Even if this were not so, the continued existence of bank-operated closed-end investment companies in 1935 is ultimately irrelevant to the determination of Congressional intent in 1933.

The Board itself has recognized that activities which are unlawful if engaged in by banks may not be seen as "so closely related to banking . . . as to be a proper incident thereto." *See, e.g., Montana Shares, Inc.*, 47 Fed. Res. Bull. 767, 772 (1961). *Cf., St. Joseph Agency, Inc.*, 47 Fed. Res. Bull. 290, 293 (1961). As has already been demonstrated, Sections 16 and 21 of the Glass-Steagall Act make it unlawful for banks to engage in the operation not only of

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[9] *Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 57-58, 124 (Table 25) (1939) [hereinafter cited as "*SEC Report*"].

open-end investment companies but closed-end companies as well. Thus, the plain meaning of Section 4(c)(8) compels the conclusion that this activity cannot be a "proper incident" to banking.

B. The legislative history of the Bank Holding Company Act also shows that Congress intended to prohibit the activity in question to bank holding companies.

In 1970, Congress amended the Bank Holding Company Act to bring one-bank holding companies under its terms. At the same time, all the other provisions of the Act were subjected to "almost two years of detailed, thorough, and protracted consideration," H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 12 (1970). The House conferees noted that:

> Aside from the question of applying the Bank Holding Company Act of 1956 to one-bank holding companies . . . the most important and controversial issue was over the question of whether to retain or substantially change the 1956 definition as to what the Federal Reserve Board could permit regulated bank holding companies to engage in outside their strictly banking activities.

Id. at 13.

In the course of Congress' detailed consideration of Section 4(c)(8), it heard from a number of witnesses who complained that the "closely related" standard too restrictively bound the Federal Reserve Board in its ability to permit holding companies to engage in new forms of enterprise. *See id.* at 20. In order to "allow the Federal Reserve Board greater flexibility in determining what nonbanking activities . . . are to be permitted bank holding companies," these witnesses advocated the substitution of the phrase "functionally related" for the Section 4(c)(8) language. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970). This substitution was intended to "significantly broaden Section 4(c)(8) by the adoption of a new test." H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 19 (1970).

Both the Senate and the House passed amended versions of Section 4(c)(8) which contained this "functionally related" language, although the two Houses differed on other aspects of the Section. As a condition of replacing the "closely related" test with the government's "functionally related" language, the House bill would have expressly prohibited bank holding companies from engaging in:

> the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities . . . *whether or not any such interests are redeemable* and whether or not the securities to which any such interests relate are a fund or account or are subject to discretionary sale or purchase. . . .

115 Cong. Rec. 33133 (1969) (emphasis supplied). This prohibition would have covered both open-end and closed-end investment companies but was eliminated in Conference Committee "apparently in return for a retention of the pre-1970 'closely related' language." *Alabama Association of Inurance Agents* v. *Board of Governors of the Federal Reserve System*, 533 F.2d 224, 238 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (1977), *cert. denied*, 435 U.S. 904 (1978). The government recognized, however, that even the liberal standard of the "functionally related" language would not have permitted bank holding companies to engage in this activity even in the absence of an express prohibition, because banks themselves had long been precluded from such activity:

> We could have lived with [the "functionally related"] language. Unfortunately, on the floor of the House, they went on to say that certain activities are not functionally related to banking and listed several areas —*one we would agree with to be excluded, the securities business.* This has been traditional for years—but listed some five or more other areas where banks are operating and have been operating for many, many years.

Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Committee on Banking and Cur-

rency, 91st Cong., 2d Sess. 18 (1970) (emphasis supplied) (statement of Dr. Charls Walker, Under Secretary of the Treasury).

The Conference Report on the 1970 Amendments is unequivocal as to the meaning of this retention of the original Section 4(c)(8) standard:

> . . . Congress intends that those activities which the Board and other witnesses claim would have been permitted under the "functionally related test", *are not authorized* by our decision to retain the "so closely related" test, which is considerably less expansive and liberal than the rejected "functionally related test." The significance of the Conferees' decision regarding the language finally adopted for section 4(c)(8) is enhanced by the fact that the Congress . . . has examined and reaffirmed its determination to keep bank holding companies in banking and in only those areas which are so closely related to banking as to be proper incident thereto.

H.R. Conf. Rep. No. 91-1747, 91st Cong. 2d Sess. 21-22 (1970) (emphasis supplied). Nevertheless, as the court of appeals noted in its decision, "[c]ourts have disagreed as to . . . [the] implications" of the retention by Congress in 1970 of the original "closely related" standard of Section 4(c)(8). *Investment Company Institute* v. *Board of Governors of the Federal Reserve System,* 606 F.2d 1004, 1019 (D.C. Cir. 1979).[10]

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[10] For example, in *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System,* 533 F.2d 224 (5th Cir. 1976), *modified on other grounds,* 558 F.2d 729 (1977), *cert. denied,* 435 U.S. 904 (1978), the Fifth Circuit found that "[a]ny liberalization of the standards" effected by other wording changes in section 4(c)(8) "was largely if not wholly offset by the Conference Committee's rejection of the 'functionally related standard' and the addition of the 'public benefits test.' " 533 F.2d at 239. The District of Columbia Circuit, on the other hand, has written that "it is plain that Congress intended to expand [the Board's] latitude in substantial degree." *National Courier Association* v. *Board of Governors of the Federal Reserve System,* 516 F.2d 1229, 1236 (D.C. Cir. 1975).

Whatever the precise implications of retaining the standard, however, it at least remains clear that activities prohibited to banks cannot be "closely related" or a "proper incident" to banking. Indeed, the Board itself told Congress that bank holding companies "should be regarded principally as a convenient alternative organizational arrangement for performing activities *that banks may perform themselves.*" *Hearings on H.R. 6778 Before the House Committee on Banking and Currency,* 91st Cong., 1st Sess. 208 (1969) (statement of J. L. Robertson, Vice-Chairman of the Federal Reserve Board) (emphasis supplied). Petitioner's present attempt to elevate the "convenient alternative organizational" form of a bank holding company over its obvious substance is precisely that against which the Board warned during its testimony in 1969:

> [W]hen Congress has clearly limited the powers of banks, they should not be permitted to circumvent such limitations . . . through affiliation in a holding company system. If the limitation is to be removed or modified, it should be done by congressional action. Before Congress does act to alter a limitation, it should decide whether the proposed activity is appropriate for banks to engage in directly. If so, the law should be changed in order that they may do so themselves, as well as through a subsidiary or through an affiliate in a holding company.

Id. at 207.

In any event, the implications of the language finally settled on by the Conference Committee, as that language applies to the regulation challenged in this case, was made explicit in the course of the debates on the floor of the Senate:

> Mr. WILLIAMS of New Jersey . . . I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.

> Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not.

116 Cong. Rec. 42430 (1970).

III. The Board's Reliance Upon Section 20 of the Glass-Steagall Act Is Misplaced.

The Board in its Brief before this Court argues that Congress intended in Section 20 of the Glass-Steagall Act to permit bank holding company affiliates to operate closed-end investment companies, provided such companies are not "engaged principally" in selling securities. Pet. Br. 19-39. But the Board's reliance upon Section 20 of the Glass-Steagall Act is misplaced. *Camp* makes clear that with respect to the operation of investment companies, Congress did not wish to permit banks to do indirectly, through affiliates, what they could not do directly. Since Congress intended to prohibit banks from operating closed- as well as open-end investment companies, Section 20 logically must be read to prohibit bank affiliates from operating closed- as well as open-end investment companies.

If the Board's reading of Section 20 were correct, a bank readily could avoid the proscriptions of Section 21 by the simple expedient of establishing an affiliate to operate its closed-end investment fund. But *Camp* makes clear that Congress intended no such loophole:

> The legislative history of the Glass-Steagall Act shows that Congress also had in mind and repeatedly focused on the more subtle hazards that arise when a commercial bank goes beyond the business of acting as fiduciary or managing agent and enters the investment banking business *either directly or by establishing an affiliate to hold and sell particular investments.*

401 U.S. at 630 (emphasis supplied).

It is a reasonable interpretation of Section 20, however, that it does not apply at all to bank holding company af-

filiates, the scope of whose nonbanking activities is regulated by the Bank Holding Company Act. The Glass-Steagall Act was passed by Congress in 1933 "to prohibit commercial banks . . . from going into the investment banking business," *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971). Sections 16 and 21 of the Act imposed an absolute prohibition on banks' engaging in specified securities-related activities. Section 19 of the Act,[11] in pertinent part, applied specifically to holding company affiliates of banks and prohibited those companies from voting their shares in the banks they owned unless they agreed not to own, control, or have any interest in a "securities company."[12] Congressional dissatisfaction with the holding company provisions of the Glass-Steagall Act began, however, almost immediately after the Act's passage. Attempts to pass legislation adequately regulating bank holding companies were made first in 1938 and continued periodically for almost 20 years. *See* S. Rep. No. 1095, 84th Cong., 1st Sess. 3-4 (1955).

Thus, since "existing provisions of law . . . [had] proved entirely inadequate to deal with the special problems presented by bank holding companies," Congress in 1956 enacted wholly new legislation designed to deal comprehensively with bank holding companies. S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955) (*quoting* testimony of William McChesney Martin, Chairman of the Federal Reserve

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[11] 48 Stat. 186, 12 U.S.C. § 61 (1958 ed.). Section 19 was amended in 1966 to remove all references to holding company affiliates. Pub. L. No. 89-485, § 13(c), 80 Stat. 242 (1966).

[12] Section 19(e) defined "securities company" as

> . . . any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort. . . .

48 Stat. 188.

Board). The more direct and streamlined provisions of this new legislation superseded as a practical matter the bank holding company provisions of Section 19 of the Glass-Steagall Act, which Congress had determined to be an "inadequate" legislative response to the problems of bank holding companies.

Congress' intention to replace the bank holding company provisions of Section 19 with the more direct provisions of the Bank Holding Company Act was made even clearer ten years later. In 1966, Section 19 was amended [13] to repeal its holding company provisions because their "effectiveness . . . is open to question and it is doubtful whether, in view of the enactment of the Bank Holding Company Act, they are now sufficiently useful to justify their retention," S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). The repeal of the "holding company affiliate" provisions of Section 19 obviated the need for a separate definition of that term in the Glass-Steagall Act, and Section 2(c) of that Act, 12 U.S.C. § 221a(c) (1958 ed.)—which defined "holding company affiliate"—was thus deleted.[14] At the same time, provisions of the Federal Reserve Act [15] were amended to delete the use of the term "holding company affiliate," and were instead made applicable merely to "affiliates." [16] To ensure that holding company affiliates remained covered by Sections 9 and 21 of the Federal Reserve Act, 12 U.S.C. §§ 321 *et seq.* and 481 *et seq.* (concerning reporting and examination requirements for state members and national banks), the definitional provisions of Section 2(b) of the Glass-Steagall Act were amended to include holding company affiliates under the general defini-

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[13] Pub. L. No. 89-485, § 13(c), 80 Stat. 242 (1966).

[14] Pub. L. No. 89-485, § 13(b), 80 Stat. 242 (1966).

[15] Pub. L. No. 43, 38 Stat. 251 (1913).

[16] Pub. L. No. 89-485, §§ 13(f), (h), 80 Stat. 243 (1966).

tion of "affiliates." [17] The Senate Report on the 1966 amendments thus states explicitly that the amendments to the definition of "affiliate" in the Glass-Steagall Act were simply "to make clear that [Sections 9 and 21 of the Federal Reserve Act] apply to holding company affiliates" of banks as well as to other bank affiliates. S. Rep. No. 1179, 89th Cong., 2d Sess. 13 (1966). The legislative history of these 1966 amendments, then, supports the contention that Congress intended to treat bank holding companies as "affiliates" solely for purposes of the Federal Reserve Act, and *not* for purposes of the Glass-Steagall Act.

While it can be argued that in amending the definitional section of the Glass-Steagall Act, Congress somehow brought bank holding companies within the terms of Section 20 of that Act, this contention would appear inconsistent with the clear expression of Congress' intent in 1966, noted above, merely to effect certain technical amendments. Moreover, it suggests that Congress, in making these technical amendments, intended to subject the securities activities of bank holding companies to Section 20 of the Glass-Steagall Act, which contained substantive provisions substantially equivalent to those it had just repealed in Section 19, without any indication that it intended such an effect. The Senate's 1966 Report indicates that Congress had no such motive:

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[17] Section 2(b) of the Glass-Steagall Act was amended to include in the definition of "affiliate" any corporation or similar entity—

> (4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

Pub. L. No. 89-485, § 13(a), 80 Stat. 242 (1966).

> [E]limination [of the holding company provisions of Section 19] would remove the confusion that results from the existence of two sets of laws that relate to the same general subject but are based on different definitions of what constitutes a holding company.[18]

S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

The Board next argues that because, as bank "affiliates", bank holding companies would not be prohibited, under its interpretation of Section 20, to engage in the operation of closed-end investment companies, that activity necessarily is one "so closely related to banking" as to be permitted under the separate provisions of the Bank Holding Company Act. But the Board's analysis of Section 4(c)(8) of the Bank Holding Company Act is as flawed as its interpretation of Section 20 of the Glass-Steagall Act.

The Glass-Steagall Act is not an authorizing statute but a prohibitory one. It does not follow that merely because a particular activity may escape its proscriptions such activity is permissible under the Bank Holding Company Act. The activity also must be so "closely related" to banking as to be a "proper incident" thereto. As the preceding section has demonstrated, operation of a closed-end fund cannot meet this test. Moreover, nothing in the legislative history suggests that Congress' real intention in 1956 and again in 1966 and 1970 was to carve out of the general prohibitions of Section 4 of the Bank Holding Company Act an exception allowing bank holding companies to engage in any securities activity—no matter how remotely related to banking or how similar to the kind of activity clearly prohibited to banks themselves under the Glass-Steagall Act—as long as the holding company did not engage *principally*

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[18] Under the Glass-Steagall Act, a holding company affiliate was defined in 1966 as a company owning more than 50 percent of the stock of any member bank, whereas under the Bank Holding Company Act, a holding company was defined in 1966 as one owning 25 percent or more of each of two or more banks, whether or not they were members of the Federal Reserve System. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

in the issuance, flotation, underwriting, sale or distribution of securities. To contend that this is what Congress meant is to disregard the central proscription of the Bank Holding Company Act and to frustrate the congressional intent which motivated its passage.

IV. The Board's Regulation Is Not Entitled To Judicial Deference

A. The concept of deference cannot override the Court's ultimate duty properly to interpret statutes.

In urging the Court to uphold the Board's action in this case, the Board predictably invokes the general principle of "deference" to the determinations of agencies charged with the duty of interpreting a particular statute in the first instance. Pet. Br. 37-38.

This Court's approach to the "deference" principle, however, has been carefully qualified by emphasis upon the limitations of that general principle. Only recently, this Court emphasized in *Mohasco Corp.* v. *Silver,* 48 U.S. L.W. 4851, 4855 (June 23, 1980) that "[a]s we have held on prior occasions, [an agency's] 'interpretation' of the statute cannot supersede the language chosen by Congress." Similarly, in *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 566 n. 20 (1979), the Court stated that deference to an interpretation by an administrative agency must be "constrained by our obligation to honor the clear meaning of a statute, *as revealed by its language, purpose, and history*" (emphasis supplied). To the same effect is the Court's statement in *Securities and Exchange Commission* v. *Sloan,* 436 U.S. 103, 118-19 (1978) (citing *Volkswagenwerk* v. *FMC,* 390 U.S. 261, 272 (1968)) that:

> [T]he courts are the final authorities on issues of statutory construction . . . and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions *that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute* (emphasis supplied) (citations omitted).

This is a case where whatever deference would normally be accorded to the Board is plainly preempted by the clear

import of the statutory provisions in question and the manifest congressional intent underlying them. The extent to which deference should be accorded here is further diminished by the frequency with which the courts have found it necessary in this area to overturn or modify determinations by federal banking authorities authorizing expanded activities by banks.[19]

The courts have also specifically overturned interpretations by the Board of the "closely related" standard to the extent that the Board's decisions were found to be inconsistent with the legislative intent under the Bank Holding Company Act. *E.g., National Courier Association* v. *Board of Governors of the Federal Reserve System,* 516 F.2d 1229, 1240-41 (D.C. Cir. 1975); *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System,* 533 F.2d 224, 241-44 (5th Cir. 1976), *modified on other grounds,* 558 F.2d 729 (5th Cir. 1977), *cert. denied,* 435 U.S. 904 (1978). Thus, the manifest tendency of the federal banking authorities to exceed the limits of the statute in authorizing expanded activities by banks (and bank holding companies) indicates that any "deference" to agency rulings in this area must be tempered by considerable skepticism.[20]

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[19] *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971); *First National Bank* v. *Dickinson,* 396 U.S. 122 (1969); *National Retailers Corp.* v. *Valley Bank,* 604 F.2d 32 (9th Cir. 1979); *Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427 (1st Cir. 1972); *Saxon* v. *Georgia Association of Independent Insurance Agents, Inc.,* 399 F.2d 1010 (5th Cir. 1968); *Baker, Watts & Co.* v. *Saxon,* 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom., Port of New York Authority* v. *Baker, Watts & Co.,* 392 F.2d 497 (D.C. Cir. 1968).

[20] The SIA itself has had direct experience with the interpretive flexibility of bank regulators. In 1977, the SIA petitioned the Board concerning private placements of securities by commercial banks. In a "Staff Study", the Board found that these placements did not constitute "dealing", "underwriting" or any other activity in violation of Section 16 or 21 of the Glass-Steagall Act. Later in 1977, the SIA petitioned the Board in connection with the sale of securities to the public by a subsidiary of Citicorp of notes issued by Citicorp. The Board found that Section 20 of the Glass-

B. The implications of the Board's regulation, especially its adverse impact on the concentration of economic power, are so sweeping they should be effected only by an unambiguous legislative mandate.

In the course of testifying last year on pending legislation to limit the scope of bank holding company activity, the Chairman of the Securities and Exchange Commission noted, *inter alia*, that the structure of the securities industry has been undergoing substantial change since the elimination in 1975 of fixed brokerage commissions and the effort to develop a national market system. He also observed that banks may achieve competitive advantages over securities firms because there are significant differences in the laws and regulations governing them from those governing securities firms. The Chairman concluded:

> The Commission shares the concerns addressed in H.R. 2747 and H.R. 2856 with respect to the proper role of banks in securities activities. . . . [T]he bills now before you raise important questions with respect to the health of our capital markets, and the continued validity of the traditional distinction between commercial and investment banking. We favor competition. Indeed, we are charged by our statutes to promote it. But these bills raise questions about the dangers of excessive concentration of economic power, about the financial service needs of the public and private sectors, about potential conflicts of interest and about unequal regulation. These are important, broad and complex issues which need to be addressed by the Congress.

Steagall Act was not violated because Citicorp and its subsidiary, viewed as a "single entity", were not engaged principally in an activity prohibited by Section 20. Again, in 1979, the SIA petitioned the Board on the issue of whether commercial banks could act as sellers of commercial paper for corporate issuers. The Board's general counsel issued an opinion to the effect that this activity was permissible, chiefly because commercial paper was not a "security" for purposes of the Glass-Steagall Act. The substance of this ruling is now the subject of another SIA petition, which has been pending before the Board for almost a year.

Hearings on H.R. 2255, H.R. 2747, H.R. 2856, H.R. 4004 Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, 96th Cong., 1st Sess. 13, 17-18 (1979).

Banks and bank holding companies not only are free from the costly regulation that burdens members of the securities industry, the sheer size of the money center banks in relation to the securities industry also suggests that the latter would be unable to compete successfully against the wealth of resources available to these banks and their affiliated holding companies.[21] For example, bank holding companies quickly became leading participants in the personal finance and mortgage banking fields after being permitted to engage in such activities.

The inability of the securities industry to compete against the money center banks would result in decreased competition in financial services. At the present time, commercial bankers and investment bankers generally compete to serve the capital needs of the same customers by offering different products. The commercial bankers offers a variety of commercial loan packages, funded by one or more banks, while the investment banker offers a variety of securities packages, funded by investors through public or private offerings. If commercial banks were allowed to offer both products, and came to dominate both financing alternatives, development of innovative financing vehicles would be stifled, and a few money center banks in effect would contral access to the capital markets by American industry. Such a result not only would be to the disadvantage of the customer seeking to satisfy his capital-raising needs in the most efficient and least costly manner, but also would dis-

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[21] As of March 31, 1980, the equity capital of all member firms of the New York Stock Exchange doing business with the public was $4.1 billion. As of the same date, the combined shareholders' equity of Citicorp and BankAmerica Corporation alone exceeded $7 billion.

tort the economy's delicate capital allocation process and lead to the realization of Judge McGowan's fears:

> [T]he Board's interpretive ruling fails to give due weight to a second evil that was thought to flow from the growth of one-bank holding companies: the centralization of economic power in the American economy. Congress was deeply concerned that the economy was becoming structured along the lines of the Japanese "Zaibatsu" system, in which economic power was concentrated in a few gigantic power centers. This concern for the structural integrity of the economy will be present even if there were fully adequate safeguards against abuse of the subsidiary bank's economic power. Yet, the Board's action in the present case, permitting bank holding companies or their affiliates to control the investment decisions for large pools of capital, would seem to portend the type of centralization of power that Congress feared in the 1970 Amendments.

Investment Company Institute v. *Board of Governors of the Federal Reserve System*, 606 F.2d 1004, 1023 (footnotes omitted).

CONCLUSION

Amicus curiae Securities Industry Association respectfully urges that for the foregoing reasons, and for the reasons set forth in Respondent's Brief, the decision of the court of appeals below should be affirmed.

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